The Economist

APRIL 29TH–MAY 5TH 2006 www.economist.com

Labour's Black April

China and the internet

The business of American football

Tragicomic Italy

Marijuana as a useful medicine

On top of the world

Goldman Sachs and the culture of risk

ONLINE FEATURES
Cities Guide Go
Canada Go
Audio interviews Go
Classifieds Go

PRINT EDITION

Full contents
Enlarge current cover
Past issues/regional covers

GLOBAL AGENDA
POLITICS THIS WEEK
BUSINESS THIS WEEK
OPINION
Leaders
Letters
WORLD
United States
The Americas
Asia
Middle East & Africa
Europe
Britain
Country Briefings
Cities Guide
SURVEYS
BUSINESS
Management Reading
Business Education
Executive Dialogue
FINANCE & ECONOMICS
Economics Focus
Economics A-Z
SCIENCE & TECHNOLOGY
Technology Quarterly
PEOPLE
Obituary
BOOKS & ARTS
Catch if you can
Style Guide
MARKETS & DATA
Weekly Indicators
Currencies
Big Mac Index
DIVERSIONS
RESEARCH TOOLS
CLASSIFIEDS
DELIVERY OPTIONS
E-mail Newsletters
Mobile Edition
RSS Feeds
The Economist Group
Economist Intelligence Unit
Economist Conferences
The World In
Intelligent Life
CFO
Roll Call
European Voice
EuroFinance Conferences
Economist Diaries and Business Gifts

Print Edition April 29th 2006

On the cover
In its taste for risk, Goldman Sachs, the world's leading investment bank epitomises the modern financial system: leader

Previous print editions
Apr 22nd 2006
Apr 15th 2006
Apr 8th 2006
Apr 1st 2006
Mar 25th 2006
More print editions and covers »

Subscribe
Subscribe to the print edition
Or buy a Web subscription for full access online
RSS feeds
Receive this page by RSS feed

The world this week
Politics this week
Business this week

Leaders
Goldman Sachs
On top of the world

Britain's government
Labour's Black April

Iraq's new prime minister
A blockage removed

Trade
Five minutes to midnight

Belarus and Azerbaijan
Use a long spoon

Letters
On soft paternalism, space, coffee certification,Romanian gold, tax

Special Report
China and the internet
The party, the people and the power of cyber-talk

United States
Los Angeles schools
The mayor takes charge

Denver schools
How's my teaching?

Virginia politics
The presidential double

Refugee policy
Less hope, a longer wait

The White House reshuffle
Snow job

Presidential legacies
Dude, where's your library?

New York's Hasidic Jews
In God we tussle

Hawaii
Sacred or profane?

Lexington
Premium pressure

The Americas
The Brazilian Amazon
How green was my valley

Tropical rainforests
Giving credit

Haiti's elections
Tiptoeing toward stability

Racial politics in Guyana
Good hopes and bad intentions

Cuba
Fidel, the electrician

Asia
China
Struggling to keep the lid on

Business
American sports
In a league of its own

Steel
Arcelor, up in arms

Toll roads
Merging lanes

Business-school deans
Light on their feet

Internet video
Clip culture

Chinese cinema
No direction

Face value
Texan sangfroid

Special Report
Goldman Sachs
Behind the brass plate

Finance & Economics
Japan's financial institutions
A first, gentle shake

Chinese banks
Drag on the dragon

Listed funds
Cocktail hour

Earnings guidance
The sound of silence

The economics of smoking
Filtering the evidence

Economics focus
A host of problems

Science & Technology
Medical marijuana
Reefer madness

Particle physics
The collider calamity

AIDS
Bitter fruit

Books & Arts
Growth and its consequences
The perils of prosperity

The internet
Terror.com

China's Long March
The long and winding road

German banking
What if...

New cinema
Altman in excelsis

Van Gogh and Gauguin
Sunny side down

Advertisement

Knights and pawns check king

Sri Lanka
The gates of war open

India
Caste and cash

Vietnam
Manh alive

The Solomon Islands
The in and out prime minister

Middle East & Africa

Egypt's bombs
Punishing the West, all things secular and Egyptians too

Israel's new government
Farewell to the generals

Iraq's new prime minister
A man they can deal with

African poverty
The magnificent seven

Eritrea
A myth of self-reliance

Europe

Italy's politics
A dog's dinner for Romano Prodi

French trade unions
Power without responsibility

Hungary's election
The re-election precedent

Russian energy
Customer relations, Gazprom-style

Berlin's finances
Painful relief

Charlemagne
Euro blues

Britain

Labour and crime
Law and disorder

Labour and sex
Caught in the storm

Labour and the health service
Trimming the fat

M&S and Debenhams
A tale of two retailers

Local elections
Of rats and voters

Secondary education
Leave none behind

The BBC 2.0
Auntie on tap

Bagehot
It's the party, stupid

Shin Sang-Ok

Economic and Financial Indicators

Overview

Output, demand and jobs

Prices and wages

Labour disputes

Money and interest rates

The Economist commodity price index

Stockmarkets

Trade, exchange rates and budgets

Trade in commercial services

Emerging-Market Indicators

Overview

GDP per person, 2004

Economy

Financial markets

Articles flagged with this icon are printed only in the British edition of *The Economist*

Advertisement

Classifieds

Jobs
DIRECTOR (The Tumen River Area Development Programme) Background of the Programme: ....

Business / Consumer
Business Opportunity - WSI Internet Start Your Own Busines....

Jobs
The American University of Beirut (AUB) is seeking candidates for....

Jobs
POST: GRADE: D-1 VACANCY NO: VA1-02-2006 ....

Jobs
MORE RESPONSIBILITY, MORE FREEDOM, MORE IMPACT ....

Jobs
The University of Minnesota, the state's Land Grant University, invites applications and nominations....

Sponsors' feature

Copyright © The Economist Newspaper Limited 2006. All rights reserved. | Legal disclaimer | Accessibility | Privacy policy | Terms & Conditions | Help

document created by *NiftyPDF*

Politics this week

Apr 27th 2006
From The Economist print edition

EPA

The king of **Nepal** bowed to weeks of street protests and announced the recall of parliament, suspended for the past four years. Maoist rebels called a three-month ceasefire, while demanding elections to an assembly that would draw up a new constitution. See article

Sri Lanka's armed forces launched heavy attacks against Tamil Tiger rebels in the east of the country, following a suicide-bombing that gravely injured the army's chief of staff and killed several of his bodyguards. See article

The prime minister of the **Solomon Islands** was forced out of office, a week after his election prompted riots that wrecked the country's capital, Honiara. See article

Thailand's judges were due to meet, at the request of the king, to untangle the mess caused by an election that the opposition boycotted and that has failed to produce a quorum for parliament.

China's president, **Hu Jintao**, completed a week-long tour of Africa, his second in three years, showing the importance that China attaches to the continent as a source of oil and raw materials. During the visit, he signed a deal with Nigeria for four oil-drilling licences, committing China to invest $4 billion in infrastructure projects in the country.

Defender of the faith

George Bush picked **Tony Snow**, a broadcaster on the stridently conservative Fox News network, as the White House's new press spokesman. Meanwhile, Mr Bush's job **approval rating** slipped to another low: 32%, according to a poll for CNN. See article

Karl Rove gave testimony to a second grand jury investigating the Plame affair. The first grand jury brought charges against “Scooter” Libby, Dick Cheney's former chief of staff, but prosecutors left the door open on further indictments.

Mr Bush went to California, where he called on Congress to pass a bill giving official status to **illegal immigrants** and said punitive measures being pushed by some congressmen were “unrealistic”.

In **New Orleans's** primary election for mayor, Ray Nagin, the incumbent, received 38% of the vote. He now faces Mitch Landrieu, Louisiana's lieutenant-governor, in a run-off on May 20th.

After months of bickering, Larry Silverstein agreed to a deal that reduces his role in the development of the World Trade Centre site in **New York**. The developer will cede control of the

pivotal Freedom Tower to the city's port authority after it is built.

An opening for trade

EPA

Panama announced a plan to double the capacity of the **Panama Canal** to accommodate giant container-ships. The project, due to be completed by 2014, is expected to cost $5.3 billion and will be paid for by toll increases. The plan will probably be put to a national referendum this year.

Kofi Annan, the UN secretary-general, hailed **Haiti**'s peaceful parliamentary elections as a crucial step on the road to stability. President René Préval is expected to form a coalition government. See article

Shadows of death

EPA

A series of events were held in **Ukraine** to mark the 20th anniversary of the **Chernobyl** disaster, when a nuclear reactor blew up on April 26th 1986. President Viktor Yushchenko joined ceremonies in memory of those who died, or still suffer, from radiation exposure. In neighbouring **Belarus**, opposition groups used the occasion to renew protests against the government of Alyaksandr Lukashenka.

Hungary's Socialist-led government was re-elected to office. The prime minister, Ferenc Gyurcsany, promised to deal with the country's economic problems, but foreign investors remain fretful about huge budget and current-account deficits. See article

Members of the **European Parliament** were outraged by claims that the city of Strasbourg was overcharging them for rent for two of their buildings. Most MEPs would rather relocate entirely to Brussels; only the determined opposition of the French government forces them to meet every month in Strasbourg.

Rumblings over **Russian gas exports** to the European Union continued. Gazprom, Russia's energy giant, denied that it had made threats to shift supplies to other customers even though Vladimir Putin, Russia's president, later appeared to repeat them. The Russians insist they should be able to buy European energy companies even while rejecting demands for more liberalised energy markets. See article

Inch by inch

In **Iraq**, Jawad al-Maliki, who took over as prime minister after Ibrahim al-Jaafari was at last persuaded to step aside, said he hopes to form a government in about two weeks. See article

A deal between Ehud Olmert, the head of the Kadima party, and Amir Peretz, the head of Labour, under which Mr Peretz is to be the new defence minister, opened the way for a new **Israeli government**. See article

In the third terrorist attack in 18 months on **Egypt**'s Red Sea coast, three suicide-bombers

attacked the quiet resort of Dahab, killing at least 24 people, most of them Egyptians. This was followed by two suicide-bomb attacks on the Sinai base of an international peacekeeping group that killed only the perpetrators. See article

Both **Osama bin Laden** and **Abu Musab al-Zarqawi**, al-Qaeda's leader in Iraq, made appeals to Muslims to support the group's war with the West: Mr bin Laden on an audiotape and Mr Zarqawi in a video posted on the internet.

The UN Security Council passed a resolution imposing travel and financial sanctions on four Sudanese, including a former commander of the air force and a leader of a pro-government militia, accused of war crimes in Sudan's **Darfur** region. It is the first time that any individuals involved in the Darfur conflict have been held directly responsible for their actions.

A group of public-health experts attacked the World Bank for incompetence, falsification of statistics and medical malpractice in its attempt to tackle **malaria**, a preventable disease which kills over a million people each year, many in Africa. The charges, and a rebuttal from the bank, were published in the *Lancet* to coincide with Africa Malaria Day. The bank admits past incompetence, but argues its new malaria policy is more outcome-based and transparent than critics acknowledge.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Business this week

Apr 27th 2006
From The Economist print edition

The European Union's second-highest court heard an appeal from **Microsoft** that seeks to overturn the antitrust ruling imposed in 2004. The software company denied it had breached EU competition rules by, among other things, bundling its Media Player into Windows. The court should give its decision by the end of the year.

Sun Microsystems announced that Jonathan Schwartz, number two at the struggling maker of high-end computers, would replace Scott McNealy as chief executive. Mr McNealy, who co-founded the company and has held the post since 1984, will stay on as chairman. Sun has struggled in vain to reinvent itself since the bursting of the dotcom bubble.

Blackstone Group is to take a 4.5% strategic stake in **Deutsche Telekom** for *euro*2.7 billion ($3.3 billion). Germany's new government welcomed the move. A ruckus ensued in the run-up to last year's general election when foreign-investment firms were compared to “swarms of locusts”.

Laying it out

Kenneth Lay took the stand at the **Enron** trial. The firm's former chairman and chief executive blamed Andrew Fastow, the former chief financial officer who struck a plea-bargain deal with prosecutors, for the fraud that led to the energy-trader's collapse and said a media “witch hunt” fed a hostile investment environment before Enron's bankruptcy. Mr Lay denies charges of trying to cover up the perilous state of Enron's finances.

There was further consolidation in the infrastructure industry as Spain's **Abertis** agreed to merge with Italy's **Autostrade**. The combined company, valued at around *euro*25 billion ($31 billion), will be the world's largest operator of toll-roads. Its assets are mostly in Italy, Spain and France, but also include the Dulles Greenway toll-road leading to Washington's international airport. See article

Nissan and **Honda** continued the recent success of Japanese carmakers by reporting record net profits for the year ending March 31st. Honda's fourth-quarter profit rose by 133% compared with a year earlier. The news provided sharp contrast to the fortunes of Detroit. Last week, **General Motors** reported its sixth straight quarterly loss (though at $323m, the result was better than expected) and **Ford** announced its biggest quarterly loss in four years—$1.19 billion—as it took charges for its restructuring plans.

Bucking the trend of most large airlines worldwide, **Emirates** reported a net profit of 2.5 billion dirhams ($674m) for the year ending March 31st—its 18th consecutive annual profit—despite an increase in fuel costs. Based in Dubai, Emirates is planning to double in size over the next few years the better to compete on long-haul routes.

In a long-running takeover battle, **Engelhard**, a maker of catalytic converters, rejected a sweetened takeover offer from **BASF** and will buy back 20% of its outstanding shares to defend

itself against the German chemical company's bid.

Clean-air act

Reynolds American (the parent company of R.J. Reynolds Tobacco) agreed to pay $3.5 billion for **Conwood**, a maker of smokeless-tobacco products that traces its origins back to snuff manufacturing in the late 18th century. Although cigarette consumption is declining, the market for smokeless (mostly snuff and chewable) tobacco, such as Conwood's Kodiak brand, has been growing at 5% a year.

In an effort to control a racing economy, **China's central bank** raised interest rates for the first time in 18 months. It also announced guidelines to rein in banks' lending. See article

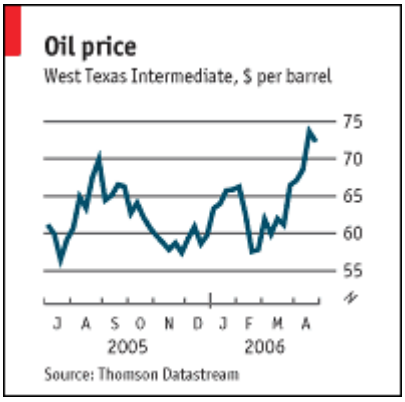
Speculation that a silver-backed exchange-traded fund from Barclays Global Investors will soon be launched helped the price of **silver** claw back some of its recent loss. Investors cashing in profits from record highs contributed to volatile trading that had seen the metal fall by 15% on April 21st.

Three-month **copper** futures broke the $7,000 a tonne barrier amid concern of strikes at mines in Chile and Mexico.

BP announced that net income for the first quarter had fallen by 15% in a year, to $5.6 billion. The company's profit was partly affected by last year's shutdown of its oil refinery at Texas City following an explosion that killed 15 people. This week federal regulators fined BP's North American operations $2.4m for safety violations at a refinery in Ohio that were "similar to those found during an investigation" of the fatal blast.

Slippery slopes

The price of **oil** eased a little after touching $75 a barrel in trading late last week. Meanwhile, George Bush said he was suspending deposits to America's Strategic Petroleum Reserve until the autumn in an effort to boost oil supplies. The move (which will have a small effect on overall oil supply) comes amid growing political pressure in the United States over high petrol prices. See article



Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Goldman Sachs

On top of the world

Apr 27th 2006
From The Economist print edition

In its taste for risk, the world's leading investment bank epitomises the modern financial system

Image Bank

BY ANY measure, Goldman Sachs is a formidable company. The bank knocks the spots off its competitors, whether in pure “investment banking”, the traditional craft of underwriting and mergers and acquisitions in which it made its name, or in its new focus, trading for customers and its own account. Even compared with leaders in other industries, Goldman makes spectacular returns. Among its latest record-busting yardsticks was a 40% quarterly return on equity. The average pay-packet of its 24,000 staff last year was $520,000—and that includes a lot of assistants and secretaries.

This makes the bank an easy target for populist politicians and tabloid newspapers. The real reason why Goldman should matter to outsiders is not because it is a manufacturer of millionaires (good luck to it); but because it stands at the centre of a two-decade-long transformation of the financial markets and a new approach to risk.

Business risks that were once seen as a lumpy fact of life are now routinely sliced up and packaged into combinations that generally suit issuers and investors alike. At the heart of the change has been the development of huge markets in swaps, derivatives and other complex and often opaque instruments that allow the transfer of risk from one party to another. From small beginnings in 1987, the face value of contracts in interest-rate and currency derivatives is now more than $200 trillion—16 times America's GDP. A further $17 trillion is outstanding in (even newer) credit-default swaps, which allow bond investors to lay off the risk of issuers defaulting.

Led by Goldman, investment banks have innovated at a furious pace and changed the mix of their

own businesses. They have taken on more risk as they have moved from more transparent markets, in which margins are slim, to more profitable portfolios of derivatives and direct private-equity investments. The face value of Goldman's derivatives exposure is more than $1 trillion, although the bank says that its net exposure, once you offset all its positions, is $58 billion, against shareholders' funds of $28 billion. The bankers' innovations have brought huge rewards to their industry. In the past decade it has garnered revenues of more than $125 billion, more than three times the level in the previous decade.

Simply the best

This huge new risk industry has produced gains for people far away from Wall Street and the City of London. Car companies have been able to hedge away many risks that once were seen as an incurable part of the business—and thus focus on what they do best. Pension funds have been able to shape their portfolios to fit their appetite for risk. Friction is bad for economies; the risk industry reduces it to all our benefits.

Yet the sheer size of the numbers involved does mean it is worth raising three questions. How exactly has Goldman and its industry achieved this? Can it be sustained? And what should happen if something goes wrong?

Like most of its rivals, Goldman is a difficult institution for outsiders to understand. Until 1999 it was a private partnership. With public ownership came greater reporting responsibilities, but precisely what Goldman is up to remains obscure. The bank likes to say that it still relies a lot on traditional investment banking, but Goldman's accounts show that its profits come increasingly from trading. The sharp-suited investment bankers act as a sales force for less-well-dressed colleagues who work out how to make money from swaps, options and direct investments (see article).

Goldman was not the first to realise that new financial techniques had the potential to alter risk management for companies of all kinds. Bankers Trust, now part of Deutsche Bank, was arguably quickest off the mark. But once it joined the risk-management game, Goldman steadily accumulated market nous. It applied this by building a proprietary technology system, shunning the off-the-shelf products used by many of its competitors. People who have left Goldman say that this system is unmatched at rivals. One consequence is that Goldman seems confident that it can take more risks than its competitors do. Its trading revenues are the most volatile among big investment banks and it has the most days when it loses money. Overall, however, it makes the most money.

Inside the black box

But for how long? The market doubts the run of huge profits can last. Goldman's shares are valued less richly than those of competitors it so obviously outwits. Moreover, investment banks are less highly valued than less glamorous commercial banks and retail brokerage firms.

This could be because investors think Goldman will struggle to sustain the breakneck innovation that keeps it ahead of others. Goldman's ascendancy is already showing stresses—most recently the struggle to manage conflicts of interests across its business lines. Hank Paulson, Goldman's boss, recently chastised its London team of investment bankers for appearing too aggressive in their offers to buy companies, thereby threatening the bank's reputation for being an adviser. In Japan, for just this reason, some of Goldman's M&A customers have deserted it for rivals.

These kerfuffles show that conflicts of interest can probably be solved by market pressure rather than intervention by regulators. A bigger problem for both investors and regulators has to do with risk itself. Outsiders—and perhaps even insiders—find it hard to judge whether Goldman's business is sustainably good or has thrived thanks to a dose of unsustainable good luck and skill. In addition, the very improvements in risk management that have spread risk far and wide make it harder to know where risk is concentrated or how risks might combine to threaten the system's overall health.

So far central banks have concluded that the system is more robust than it was. But the trading models that have propelled Goldman will be tested one day. At worst, the bank itself—or, more likely, a second-tier rival or a hedge fund—might fall into the kind of dramatic spiral that killed off Long-Term Capital Management (LTCM), a hedge fund, in the late 1990s. Financial markets have always been subject to crises.

Any crisis would affect Goldman, because it is so intertwined with the system. The bank says it keeps plenty of liquid reserves against the dread day. It might well profit from any crisis (it did from LTCM). But the chances are that some banks, somewhere, will get into serious trouble.

If that happens, the losses of any bank will be for its shareholders; they should not expect any bail-out. The wider question has to do with systemic risk. If the much vaunted systems do not work, then the central banks will have to step in (as the Federal Reserve did with LTCM). In the past, though, such collapses did less damage to the financial system than the regulatory over-reaction that followed them. If policymakers were to respond to the next crisis by ushering in a more conservative regime that severely limited financial risk-modelling and risk-management, the global economy would be the poorer for it. That is what should stick in people's minds when the day comes. Until then, why not do something too often forgotten? Love Goldman or hate it, you ought to admire it and the system it epitomises. And hang on tight.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Britain's government

Labour's Black April

Apr 27th 2006
From The Economist print edition

Tony Blair's government is paying the price for massive meddling

Reuters

IN A single day in September 1992, Britain's ruling Conservative Party lost something priceless: its claim to be a sound manager of the economy. After the pound was turfed out of the European exchange-rate mechanism on that “Black Wednesday”, John Major's government never recovered its authority. For the past decade, the economy has been tranquil, thanks to good luck as well as good management. So voters are more inclined to judge Tony Blair's administration on its ability to manage public services. A series of mishaps on this front now threatens Labour with its own “Black April”.

This week Charles Clarke, the home secretary, revealed that more than 1,000 foreign criminals had been released from prison, after serving their sentences, without being considered for deportation (see article). This caused fury in the press and calls for Mr Clarke's resignation. Whether foreigners should automatically be up for deportation after doing time is open to debate: they have, after all, paid their dues, just like native criminals have. But that is the government's policy—and the government failed to carry it out.

If this were the only recent blunder, it might not matter much. After all, the Home Office is a notoriously difficult department to run. But the charge of incompetence goes a lot wider. Indeed, in one area of business, Labour has proved itself more shambolic than those governments on mainland Europe that Britons like to deride: subsidy payments to farmers have been delayed so long that the European Commission may fine Britain for missing a June 30th deadline.

More troublesome are blunders in areas Mr Blair cares about. One is the National Health Service (see article). The government admitted this week that new staff contracts have cost £610m ($1.1

billion) more than originally budgeted. The NHS was nearly £1 billion in deficit for the financial year to March, despite record subsidies. And the government appears technically as well as financially incompetent in its dealings with the health service: it recently had to withdraw and correct a vital price list for its new hospital-payments system.

Another of Labour's main goals has been to direct more money to poor children through a new system of tax credits. Here again things have gone wrong. The Parliamentary Ombudsman issued a scathing report last year on how the credits were being administered. And this week Parliament's Public Accounts Committee revealed that, for the second year running, the Treasury has paid out £2 billion too much.

If this clutch of mistakes were no more than an unfortunate coincidence, they would still amount to an indictment of the government's managerial competence. But Labour's tendency to blunder is rooted in a faulty approach to government that goes back a long way. From the moment the party took office, in May 1997, it has suffered a bad case of initiativitis. Mr Blair and his ministers have all too often responded tactically to the agenda of the popular press rather than thinking strategically.

This has been most apparent at the Home Office, where the government has concentrated on passing headline-grabbing laws, while neglecting the duller but more important business of applying existing policies effectively. Those who point this out do not flourish. For instance, current “reform” plans include downgrading the post of the independent chief inspector of prisons. Its current occupant, Anne Owers, was one of the first to warn that foreign prisoners were being ignored.

Labour's record is not uniformly grim, nor are all its initiatives misconceived. The plan to improve the NHS by introducing more market pressures within it, for instance, is a promising one. But its chances of success have been imperilled by poor execution: the government threw sackloads of money at the health service before reforming it.

Mr Blair and his team have sought to do too much, often too fast, without thinking through the implications of the reforms they advocate. Their apparently uncontrollable urge to meddle in everything, constantly seeking to occupy the visionary high ground, saps morale in public services and makes it almost impossible to manage in the here and now.

The lesson from Threadneedle Street

Interestingly, one bit of government works rather well, thanks to one of Labour's earliest reforms. Monetary policy may have done for Mr Major's government but in the hands of the independent Bank of England it has been trouble-free. That is because the Bank has been given a clear remit—the inflation target—and left to get on with meeting it.

The lesson is to do more by doing less. It seems unlikely that Labour can stomach such a self-denying ordinance, but the danger of its Black April is clear. As the Conservatives know to their cost, once a reputation for competence has been lost, it is virtually impossible to regain.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Iraq's new prime minister

A blockage removed

Apr 27th 2006
From The Economist print edition

Now everything depends on America keeping its nerve

AP

IMAGINE a fruit machine whose wheels spin for four months after you pull the handle until it eventually decides whether you have won or lost. That is what Iraq's experiment with democracy has been like so far. Iraqis risked life and limb to vote in their general election in December, and they still do not have a functioning government to show for it.

Last week one thing that was gumming up the machine's works—a personality clash centred on the would-be prime ministership of Ibrahim al-Jaafari—was removed. Mr Jaafari agreed to step aside to make way for a more effective Shia politician, Jawad al-Maliki. But Mr Maliki has much work to do before he can construct a coalition that lures the Sunni Arabs into sharing power with the Shias and Kurds (see article). So the wheels spin on, and in the meantime many Iraqis have lost faith in the democratic gamble they took at the end of last year. They have moved on.

Events have moved on too, in the wrong direction. While Iraq's parliamentarians have been quarrelling in the safety of Baghdad's green zone, the country has entered the early stages of a sectarian war. Since the bombing of a Shia shrine in Samarra in February, Shia militias, abetted by the Shia-dominated government forces, have increasingly abandoned forbearance in the face of Sunni terrorism and started to take their revenge. As America's ambassador, Zalmay Khalilzad, concedes, all the infrastructure for civil war is now in place.

The next steps in Iraq will have to be guided by this new reality. For a start, it is time to abandon any hope that the increasingly widespread violence can be suppressed any time soon either by Iraqi politics or by American military action. American forces have lately become better at counter-insurgency operations but their numbers are too few and growing smaller. On current plans fewer than 100,000 American troops are expected to be in Iraq at the end of this year, and by the end

of next year no more than 60,000. Barring an unlikely injection of new political will in Washington, all that can be hoped for is that George Bush will manage this reduction in a way that gives the new government a fighting chance.

For that, he should at least keep the plans flexible. He must be willing to slow down the withdrawals if the violence soars and to keep a capable force in the most unruly parts, including western Iraq, for some time after the rest of the country is self-run. Aid and reconstruction should become a growing priority as the military effort slackens. These details are important. Indeed, they may represent all the difference that exists between “cutting and running” and “staying the course”.

Avoiding the worst

Whatever happens, there will now be no orderly transition to democratic government in Iraq. Nor at this stage can Iraq's own politics resolve things at a stroke. Even if Mr Maliki does manage to draw some Sunni Arabs into his administration, other Sunni groups, aided by al-Qaeda types, will fight on, along with some Shias who want total victory over their rivals. The grim prospect is for several more years of violence in which a reduced American force does what it can to hold the country together, support the new government and tilt the battle against the insurgents. It will be slow and gruelling. But the prospect of quitting altogether, leaving behind an emboldened al-Qaeda and a new failed state in the heart of the Middle East, would be much worse.

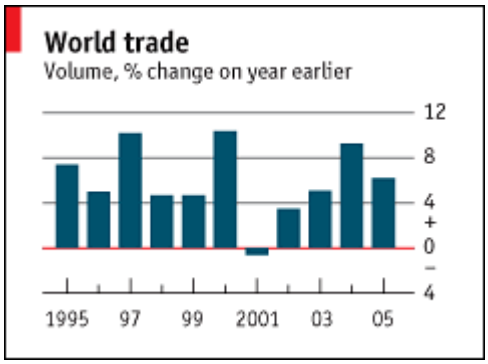
Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Trade

Five minutes to midnight

Apr 27th 2006
From The Economist print edition

Will politicians realise the global trade round is worth saving before it is too late?



TRADE ministers look upon negotiating deadlines much as Italians treat the rules of the road: useful in principle but almost always worth ignoring in practice. So a depressing inevitability hangs over negotiators' scorn this week for yet another self-imposed deadline in the Doha round of global trade talks. No matter that at their gathering in Hong Kong last December ministers solemnly declared that by April 30th they would agree on a framework to free farm trade and slash industrial tariffs. April 30th is here and a deal is still as remote as ever.

At what point does the inability to strike a deal mean the Doha round has failed? History is a poor guide. Previous trade rounds have all eventually succeeded, often after dragging on for years. But the Doha talks do not have this luxury. To negotiate a deal that cannot immediately be picked apart by Congress, George Bush needs trade-promotion authority. TPA runs out in June 2007 and congressional scepticism about globalisation means it is unlikely to be extended. In short, any Doha deal must be ready by the end of 2006.

Pessimists reckon the Doha round is already dead. The differences between America and Europe are “irreconcilable”, says Bill Thomas, the most influential Republican voice on trade in the House of Representatives. Mr Bush's decision to move Rob Portman, his main trade negotiator, to another job running the budget is a signal to some that the White House has abandoned all hope of a Doha deal. Many gibe, with some reason, at Peter Mandelson, Europe's main trade man, for spending more time dishing out blame for the impasse than suggesting ways out of it.

In fact, it is not too late for Doha to succeed. Although time is short, the negotiators probably have until the summer to thrash out the framework of a deal so as to settle the details by the end of the year. The technicalities prevent presidents and prime ministers from clinching a Doha deal at a single sitting, but the technocrats in Geneva cannot get much further without a big political push. Doha's prospects, therefore, depend on politicians shaking off their complacency.

Do the Doha shuffle

The stakes are high, but subtle. The world economy will neither collapse if the Doha round fails, nor will poverty be eradicated if it succeeds. The direct economic gains from Doha are well worth having, but the long-term consequences of failure should give the politicians most reason to act. If Doha fails, the world will, at best, shift towards bilateral and regional deals. At worst, the multilateral system would wither.

This threat alone ought to dispel today's reckless complacency. Some emerging economies, such as Brazil, have much to gain from freer global farm trade. India could be a big winner from freer trade in services. Both will lose from a tangle of regional deals. The cuts in industrial tariffs asked of them are not politically hard—and would be economically good. India and Nigeria have been slashing their tariffs unilaterally, rightly recognising the gains from openness. It is brinkmanship more than scepticism about trade that has driven the emerging world to demand the right to keep high tariffs.

America's reason to rescue Doha is different, but no less powerful. Since its tariffs are already low, America's main contribution to this round is to cut farm subsidies. The need to cut government spending means these handouts are likely to fall anyway over the next few years. Moreover, the Bush White House needs an economic-policy success. With entitlement reform dead and tax reform going nowhere, a Doha deal could be one of the few achievements of Mr Bush's second term.

Europe—and especially France—poses the biggest problem. After Jacques Chirac's recent retreat over labour-market reform, there is little political appetite to take on French farmers. The best hope is for other Europeans, led by Britain and Germany, to join America and the big emerging markets to isolate France and shame it into a deal. That will take courage; and the clock is ticking.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Belarus and Azerbaijan

Use a long spoon

Apr 27th 2006
From The Economist print edition

A tale of two presidents, and of American short-sightedness

Reuters

TWO rigged elections, with political arrests before the vote and protesters battered afterwards; behind them, two moustachioed, post-Soviet rulers. The balder one, Alyaksandr Lukashenka, was reviled by the United States before and after last month's pointless presidential poll in Belarus. The other—Ilham Aliev of Azerbaijan, whose allies swept the board in an absurd parliamentary vote last year—this week fulfils his longstanding ambition to meet George Bush in America. Mr Bush's hospitality is a mistake, for two reasons.

The first is moral. Mr Aliev inherited his presidency from his father in 2003; the Alievs have run Azerbaijan for almost all its post-Soviet existence, as Mr Lukashenka has Belarus. Under Aliev junior, human rights have been extolled in theory but abused in practice, probably as much as in Belarus. And Azerbaijan is a world champion of corruption. Still, the use of double standards in foreign policy is not exactly a surprise: even governments committed to spreading democracy must compromise and hold their noses occasionally. The important question may not be whether Mr Aliev's visit is morally defensible, but whether it is politically sensible. It is not.

Here is the case for overlooking in Mr Aliev what is excoriated in Mr Lukashenka. Belarus is a poor, landlocked Slavic nation; Azerbaijan is a Muslim petro-state on the shores of the Caspian Sea. Oil and gas are starting to flow via twin pipelines from its offshore deposits to the Mediterranean. Its southern neighbour is Iran: Donald Rumsfeld, America's defence secretary, has been a mysteriously frequent visitor, and rumours swirl about just how helpful Mr Aliev is being with America's military operations. Azerbaijan's northern neighbour is Russia: Mr Aliev is part of the West's competition with the Kremlin for influence in the former Soviet Union.

In this competition the Americans can sometimes afford to be principled. For example, they denounced Islam Karimov, the brutal president of Uzbekistan, after his troops massacred protesters last year, even though it cost them an airbase. But oil and geography supposedly make Azerbaijan too important to risk alienating its president. In any case—and unlike in Ukraine in 2004—the opposition is too weak and fractious to offer a real alternative. When they meet, it is said, Mr Bush will try to nudge his guest along the path to democracy.

Unfortunately, Mr Aliev has already proved adept at simulating liberal instincts, rationalising abuses and promising improvements: Azerbaijan, he will doubtless plead in Washington, DC, is a country in transition. But, in deed, Mr Aliev has been intolerant of opposition and too tolerant of corruption and inequality. The oil billions about to flood into Azerbaijan will reinforce his already formidable position. And in his part of the world, where the top man is thought responsible for more or less everything, a handshake from Mr Bush will look like a cast-iron imprimatur, no matter what lesser American officials may say. State-run television in Azerbaijan is unlikely to dwell on any criticisms Mr Bush offers in private.

This public validation will be bad for Azerbaijan, but ultimately for America too. Something else that Mr Aliev has in common with Mr Lukashenka is that neither can rule for ever. If Mr Aliev can be pressured into change, Azerbaijan has the potential to become a well-off, democratic Muslim state. If he is not, America may one day be faced with an oil-rich Muslim country in a volatile region that is disillusioned with democracy and the West, and susceptible to other ideas.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

On soft paternalism, space, coffee certification, Romanian gold, tax

Apr 27th 2006
From The Economist print edition

The Economist, 25 St James's Street, London SW1A 1HG
FAX: 020 7839 2968 E-MAIL: letters@economist.com

The dead hand of the state

SIR – Your analysis of "soft paternalism" mentioned efforts to keep people away from casinos in Missouri ("The state is looking after you", April 8th). Yet you ignored the policy of the federal government, which resorts to the prohibitions of an old-fashioned nanny state to "save" people from internet gambling. Such actions are misguided attempts to change the behaviour of 23m Americans who play poker online. In fact, Republicans in Congress believe that the lure of playing poker is so great that the government has recruited private-sector industries, including banks and internet service providers, to keep people from spending their time and money on a game they enjoy.

This hard paternalism stands in stark contrast to the state giving individuals a "nudge in the right direction" and censors the internet by removing content that politicians deem objectionable. Whether you play online or at home, for high stakes or matchsticks, people should not be subjected to heavy-handed government intrusion into their personal decisions. Whatever some may feel about gambling online, gambling with liberty is far riskier.

Michael Bolcerek
President, Poker Players Alliance
Washington, DC

SIR – The common impulse behind both hard and soft paternalism is the assumption that someone else knows how to manage your life best. It calls to mind Thoreau's fine remark: "If I knew for a certainty that a man was coming to my house with the conscious design of doing me good, I should run for my life."

Justin Wilson
Washington, DC

SIR – If we had told people in 1956 that eventually nearly every jurisdiction in the world would mandate that they must be strapped into their cars, they would probably not have believed us. The natural progression of paternalism is the inability to make decisions, requiring more and more to be made for us. The cycle is obvious. Will we eventually be taxed or fined for enjoying a sunny day without slapping on sufficient sun-protection? The only answer is for people to (gasp) use their common sense, make their own decisions about their welfare, and protect themselves and those in their immediate care. We'll end up with more scraped knees, but fewer yokes—a fair trade.

Chris Addison
Sorrento, Canada

SIR – Samuel Taylor Coleridge may well not have written “Kubla Khan” if he hadn't taken opium. Yet just a few years later, in “Dejection: an Ode”, he said a long goodbye to creativity as his addiction began to take hook. How many other great poems were not written because opium dragged Coleridge down to a sunless sea?

Bill Pletsch
Albuquerque, New Mexico

SIR – The very idea of soft paternalism annoyed me so much that I decided to take up smoking again, just to prove some ill-defined but valid point. Unfortunately, my wife intervened in the strongest possible terms, invoking the short- and long-term health of our two young children. Her intervention might be called “hard maternalism”.

Matthew Smith
London

A new space race

SIR – You are right to point out that too many in Washington perhaps overestimate China's space programme, but your reasoning that America's civilian ambitions in space are therefore a waste of valuable resources is short-sighted (“Back to the future”, April 15th). Given the strategic and economic importance of space, it is only right that the United States reforms its space acquisition process and demonstrates alternative leadership to that which may be offered in the future by China and others. This is especially so given that America's traditional role as a leader in space has been steadily undermined by the diffusion of affordable technologies over the past decade. Countries who hitherto could not even dream of such ambitions have become space powers. Moreover, the armed forces in the West increasingly rely on systems in space for a number of their critical functions. This operational success has been noted by many others who are keen to copy the sources of the technology.

John Sheldon
Programme leader, space security
Centre for Defence and International Security Studies
Henley-on-Thames, Oxfordshire

For our feathered friends

SIR – I found your article about coffee in Central America informative, but should point out that the term “Bird Friendly” was coined by the Smithsonian Migratory Bird Centre at the National Zoological Park and is a registered trademark owned by the Smithsonian Institution (“Fair enough”, April 1st). Organic farmers that also take account of the amount of shade from trees, which harbour significant levels of avian diversity, can market their coffee as Bird Friendly and enjoy premium prices above those paid for being merely organic. The “organic” and “fair trade” certification schemes are easily recognised by consumers. Coffee drinkers, especially those with bird-watching tendencies, can now add “shade” to the list, which can only help assure them that they truly get what they are paying for.

Robert Rice
Smithsonian Migratory Bird Centre
Washington, DC

SIR – Contrary to your article's assertion, the vast majority of Brazil's 220,000 coffee growers are smallholders. So if the model of small family-farms is more politically correct to the promoters of fair trade, then Brazilian coffee should not be excluded from their marketing efforts. Our smallholders, and our larger-scale enterprises, face the same challenges confronting coffee growers worldwide.

Marcelo Vieira
Brazil Specialty Coffee Association
Areado, Brazil

Tarnished metal

SIR – Just like the "partisan and excitable Romanian media", your article about a controversial gold mine in the country takes a disturbingly one-sided view ("No gold please, we're Romanian", April 8th). You say the people opposing the mine are "a mixed bunch, including anti-globalisation and Green idealists". However, you fail to mention that the majority of Romania's historians, intellectuals and environmental experts are also against the project. People living in nearby villages with unemployment rates of 50% may well show strong support. But as endless cases in sub-Saharan Africa show, people in poverty tend to favour short-term relief instead of long-term, sustainable solutions.

Andrei Roth
Berkeley, California

If only Ahab were alive

SIR – Don't underestimate the efforts of Congress in keeping the American tax code up to date ("April's hard truths", April 15th). For example:

> "Schedule A, itemised deductions, 2005. What's new: Certain whaling captains may be able to claim a charitable deduction for whale hunting expenses. See 'gifts to charity' on page A-6 for more details."

Steve Herb
Hamburg, Germany

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

China and the internet

The party, the people and the power of cyber-talk

Apr 27th 2006 | BEIJING
From The Economist print edition

At present the party has the upper hand. It is starting to sweat, though

"DO YOU know how serious a mistake you've made?" Yan Yuanzhang recalls an official asking him not long ago. Mr Yan had been summoned to Beijing's Internet Propaganda Management Office to talk about his websites. They were causing, he was told, the Communist Party to lose face. They were providing material that foreign media could use to attack China. They were illegal and must be closed down within 24 hours.

"Farewell, worker comrades," wrote Mr Yan in notices posted that day on his China-based websites, China Workers Net and Communist Net. Visitors could hear a lugubrious rendition of the communist anthem, the Internationale, through their computer speakers as they read. "Whether there is any hope of starting again, heaven knows." He says now that he will relaunch one of the two sites on May 1st, this time on a server in Taiwan.

It is remarkable that the websites lasted as long as they did. Mr Yan, who is not a party member, launched them on May 1st last year to mark Labour Day. The aim, he says, was to provide platforms for a "leftist" critique of China's embrace of "Dickensian capitalism". They did not, as he tried to explain to the city government, attack the party itself or its leaders. But they did provide something the party abhors: uncensored news about worker unrest. In September he launched a bulletin board on which visitors could directly post their comments. Messages complained about corruption, the privatisation of state-owned enterprises and the hardships of unemployed workers.

As Mr Yan talks, he gets a text message on his mobile phone. It is from Tan Jiaming, a university student in southern China who has been running a website of similar outlook, Revolutionary

Marxism. It too, the message says, has been closed. The student had posted a notice entitled “Strongly Protest the Snuffing Out of the China Workers Website by the Beijing Authorities”. He was summoned to hear a dozen officials threaten him with expulsion from his university for backing Mr Yan.

Six years ago Bill Clinton described China's efforts to restrict the internet as “sort of like trying to nail Jell-O to the wall”. But as China's web-filtering technology has grown more sophisticated, and the ranks of its internet police have swelled, some have begun to wonder. A report in 2003 by the Carnegie Endowment for International Peace suggested that, despite the difficulties the internet posed to authoritarian regimes, it could also be used to fortify them. China, the authors concluded, had been “largely successful at guiding use” of the internet. At a congressional hearing in February on American companies involved in internet business in China, a Republican congressman, Christopher Smith, said the internet there had become “a malicious tool, a cyber sledgehammer of repression”.

Some of the companies testifying at the hearing—Cisco, Google, Microsoft and Yahoo!—deserved a grilling. Why, for instance, had Microsoft, at the request of Chinese officials, removed a popular site in December from its Chinese version of MSN Spaces, a service for personal diaries and blogs? Yahoo! too had questions to answer about reports that information it provided to the police about its e-mail services had helped put dissidents behind bars. More recently Reporters Without Borders, a human-rights group, said that a Hong Kong unit of Yahoo! had given the police a Chinese user's draft e-mails. These were then used as evidence at his trial for subversion, for which he received a four-year jail sentence. Yahoo! has condemned efforts to suppress freedom of speech, but says it must obey Chinese law.

For foreign companies, the internet business in China is certainly a moral minefield. But the internet should not be dismissed as merely an instrument of control for the Communist Party. In the past three years, China has seen far more extensive use of the internet and the rapid development of groups that share views online that are by no means always the same as the party's. The numbers of internet-connected computers have more than doubled since the end of 2002, to 45.6m, and internet-users have risen by 75%, to 111m. China now has more internet-users than any country but America, and over half of them have broadband (up from 6.6% at the end of 2002). Users of instant computer-to-computer messaging systems have more than doubled, to 87m. Blogs—online personal diaries, scarcely heard of three years ago—now number more than 30m. And search engines receive over 360m requests a day.

The spread of mobile telephony has been no less spectacular. At the end of last year China had 393m mobile-phone accounts, nearly 200m more than at the end of 2002 and more than any other country. If, as many believe, China's first third-generation mobile-network licence is to be awarded in the coming year, internet access at broadband speeds will become available on mobile handsets. And, crucially, many people in towns can now afford all this technology. China's economy in the past three years has been growing at around 10% a year, enriching a growing middle class that increasingly sees the internet as an aid to information-gathering, communication and entertainment. Even many students can afford laptops. In big cities, they congregate in cafés that offer free wireless access.

Moreover, the technological transformation is spreading far into the hinterland. Almost every

county now has broadband. Internet cafés with high-speed connections are ubiquitous and cheap even in remote towns. Fixed-line internet access is still uncommon in rural homes. But in many parts of the countryside, it is possible to surf the internet at landline modem speeds using a mobile handset (though few peasants can afford to). With the government's encouragement, state-owned companies have poured quantities of money into the building of a telecoms infrastructure worthy of the rich world.

Keeping the genie half in the bottle

The government has also spent freely to keep its liberating side-effects under control. The committed few who are brave or foolhardy enough to use the internet to challenge the authorities now face a police force of some 30,000 online monitors, say foreign human-rights groups. They also say that China has jailed over 50 people for expressing views online or in text messages. Worried about the forces unleashed by rapid economic and social change, China's leaders have stepped up their efforts in recent months to control not only the internet but other media too. A handful of outspoken newspapers have been closed and their editors sacked.

At February's congressional hearing, representatives of America's internet companies argued that their presence was helping to promote access to information by encouraging the internet's development in China. Jack Krumholtz of Microsoft said the Chinese people would be the principal losers if his company's internet services ceased in China. They would be denied, he said, “an important avenue of communication and expression”. That was an exaggeration. Foreign companies help to spur competition. But it is Chinese companies—some of them listed on American stock exchanges—that in many respects, and often unwittingly, are transforming China faster.

Google's decision to set up a self-censored version of its search engine in China this year aroused a storm of criticism in America. But iResearch, a Shanghai-based market-analysis firm, says China's Baidu enjoys more than 56% of the search market; Google follows with less than a third, having been the leader three years ago. Popular features of Baidu's engine are its ability to link searches to related chat forums, and hunt for MP3 music files, most of them pirated.

Baidu's searches are not nearly as comprehensive as Google's. But self-censorship, both by Baidu and by Google in its new China-based engine, still allows information through that the party dislikes. For instance, news about the congressional hearing—ignored by China's print media—can be found on both. Entering the Chinese-character equivalents of the words “Congress America internet freedom” into Baidu produces three prominent results relating to the hearing. All are blogs. Two even contain advertisements with links to pornographic websites.

Google's engine in China produces more relevant results. But many are blocked by a firewall, the barrier between the internet in China and the rest of the world that filters out banned sites and those containing prohibited keywords. Curiously, it is the Chinese search engine with a more rigorous filtering system than Google's that provides the readiest access to uncensored information about the congressional hearing. For those who know English, the House of Representatives' website offers copies of evidence and a webcast of the entire proceedings. These are not blocked.

The firewall is porous. Imaginative users can find ways of searching for sensitive topics such as news about Falun Gong, a banned spiritual movement. In Google, entering the words “Falun Gong” will cause the entire results page to be blocked, but “FLG movement” will not. Many Chinese internet-users are well practised in configuring their internet browsers to route page requests through unblocked proxy servers outside China. These help bypass the firewall.

Blog-standard evasion

Blogs make the censors' work all the more difficult. China's fast-growing legions of bloggers know they must avoid taboo keywords, including those programmed into the Chinese version of MSN Spaces. If you enter any of those, the postings will not be shown or your attempt to set up a blog will be denied. But, as China's internet companies engage in fierce competition to draw blog traffic to their portals, few checks seem to be made about who is writing them. A blog can easily and quickly be set up on a Chinese portal, and no one asks for verifiable personal information. Bloggers often display postings that would make party censors shudder. Mr Tan, the student who used to run the Revolutionary Marxism website, has a blog on MSN Spaces that keeps up his campaign for workers' rights despite the demise of his own site and continued harassment by officials.

Human intervention is no less fallible than the firewall. In the middle of the huge open-plan newsroom of Sina Corporation in north-western Beijing, a score of censors sit in front of their screens. They are young employees whose job is to examine thousands of blogs and comments posted by internet-users on Sina's news items. It is a round-the-clock task, designed to find anything that could have got through the filters and might still offend the authorities.

Direct attacks on the party, its leaders or on the political system rarely get through (or at least, not for long). But that still allows room for far more vigorous debate on a range of social and economic issues than China has enjoyed before under Communist rule. According to Qian Hualin of the government-affiliated China Internet Network Information Centre, Chinese service-providers report that some 70% of their bandwidth is taken up with pirated music and films. That still leaves lots of room for discourse.

Even the party itself pays attention to the deluge of public comment. Eager to acquire some legitimacy, but anxious to avoid democracy, it is trying its hand at populism. The prime minister, Wen Jiabao, said last month that the government should listen “extensively” to views expressed on the internet. With few other ways of assessing the public mood, the internet is indeed a barometer, even though surveys suggest that users are hardly representative of the general population, being mainly young, better educated and male.

In 2003 many internet-users expressed outrage on bulletin boards over the beating to death in jail of just such a young, well-educated man who had been arrested for failing to carry the right identity documents. This led to the scrapping of a decades-old law giving the police sweeping powers to detain anyone suspected of staying without a permit in a place other than his registered home town. Later that year the commuting of a death sentence of a gang boss prompted a similar online furore. The Supreme Court retried the case and ordered his execution.

The knitting of a network

Guo Liang of the Chinese Academy of Social Sciences describes 2003 as a “milestone” in the development of the internet in China. During the outbreak early in the year of SARS, an often fatal respiratory disease, many people stayed at home and made extensive use of the internet to gather information and keep in touch. The government's efforts to block news of the outbreak collapsed as word spread by e-mail, computer and text message. By late 2004 home installation of broadband began to take off, and with it the growth of blogging, instant messaging and internet-based phone and video calls.

The party worries about any unregulated networking among ordinary people. It severely limits the

activities of non-governmental organisations, even straightforwardly charitable ones. It ruthlessly suppresses organised dissent. But China's love affair with the mobile phone, text and instant messaging has helped people to form networks on a scale and with a speed that is beyond the party's ability to control. Windows Messenger, Microsoft's instant-messaging system, is one popular tool. But by far the biggest share of this market is enjoyed by a Chinese company, Tencent. Its messaging service, QQ, generates revenue by linking a free online system with mobile phones, for which users must pay.

The QQ service has helped Mr Yan retain some of his online network of contacts since the closure of China Workers Net and Communist Net. He replaced the two home pages with notices inviting anyone interested in staying in touch to join a QQ chat group called China Working Class Net. Members can hold discussions with dozens of people all at once. With webcams, some chatters can also see and hear each other. Some even go in for *luoliao*, naked chatting, which is causing the authorities and parents some concern. The government, however, seems to devote more resources to controlling politics on the internet than to controlling sex.

One frequently criticised aspect of China's internet development is that nationalist diatribes have a much better chance of getting past the censors than other political comment. But nationalism has also provided a convenient cover for experimenting with new forms of mobilisation. The power of instant messaging, for instance, became evident in April last year, when it was used to organise big anti-Japanese protests in several cities. In the build-up to the protests, Sina organised an online campaign aimed at demonstrating public opposition to Japan's bid for permanent membership of the UN Security Council. Some 20m people submitted their names. Since starting a similar campaign a few weeks ago, Sina's rival, Sohu, has gathered more than 15m names. “It shows the power” of the internet, says Charles Chao, Sina's boss.

The government keeps issuing new rules to keep users of both the internet and mobile phones in line. Last September news portals were banned from publishing anything that might incite protests; anything issued in the name of any “illegal civil organisation” was also forbidden. According to news reports, the government plans this year to issue rules to require people buying pre-paid mobile phone cards to submit proof of identity: over half of China's mobile-phone accounts are not registered in any name, making it easy for criminals—or dissidents—to use them without being identified by the police. “The internet in China is a wild place, it's crazy,” says Charles Zhang, head of Sohu. “I don't think it's monitored enough.”

Catch me if you can

But the market is likely to prevail over restrictions. Limiting phone-card sales to just a few shops with the ability to process registration requirements would be a blow to mobile-phone companies and huge numbers of private vendors who thrive on such business. It is hard to see how it could be enforced any more rigorously than, say, China's ban on the unauthorised reception of satellite signals. Illegal sales of satellite dishes and cable services offering uncensored foreign satellite channels are big underground businesses in urban China.

China's news portals, in their competition for traffic, will continue to test the limits of official tolerance. And in a competitive market few internet-café operators pay attention to government requirements that users' identities should be registered. An hour on a broadband connection in an internet café in a small town can cost as little as one yuan—about 13 cents.

Research by the Chinese Academy of Social Sciences suggests the scale of the government's task. Over 20% of people surveyed in five Chinese cities last year said the internet had increased their contacts with others who shared their political interests—a far higher proportion than found in a similar survey conducted in America (8.1%) by collaborators in the investigation. Nearly half of

the respondents said going online increased their contacts with people who shared their hobbies, compared with less than 20% in the United States (networked role-playing games, growing fast in popularity in China, may partly account for this). And nearly 63% agreed that the internet gave them greater opportunities to criticise the government.

“China is changing, it's improving,” says Jack Ma, head of Alibaba, which last year took over the running of Yahoo!'s Chinese operations—for, despite an early start in China, Yahoo! has been elbowed aside by domestic rivals. “Ten years ago, 20 years ago, in Chairman Mao's time, if we came here to talk about these things [government censorship],” he begins. Then he puts an imaginary pistol to his head and, with a grin, fires it. That, of course, was when power just grew out of the barrel of a gun. Now it also grows out of the infinite, albeit virtual, barrels of the internet.

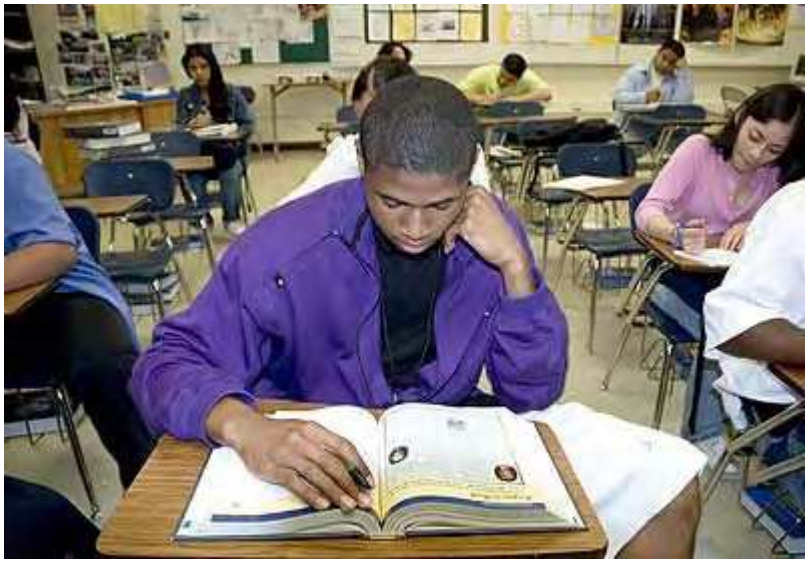
Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Los Angeles schools

The mayor takes charge

Apr 27th 2006 | LOS ANGELES
From The Economist print edition

Villaraigosa's plan is bold, but there is a very long way to go



“WE CAN'T be a great global city,” says Antonio Villaraigosa, “if we lose half of our workforce before they graduate from high school.” The hyper-energetic mayor of sprawling Los Angeles is stating the obvious. A low graduation rate from the giant Los Angeles Unified School District (LAUSD) feeds through into fewer skilled workers, more criminals and every social ill in America's second-biggest city, from drug abuse to broken families.

And the rate is low indeed. According to a study last year by Harvard's Civil Rights Project, only 45.3% of LAUSD students who started ninth grade (ie, senior high school, at the age of 14 or so) graduated four years later from 12th grade; for Latino students, who make up three-quarters of the student body, the rate was a mere 39%. School-district officials dispute the figures, saying they include as dropouts students who have simply moved away, but even their estimate—a dropout rate of around 33%—is unacceptable.

Much of the explanation is surely that in a system of 727,000 students (only New York, with 1.1m, is bigger) too many of LA's schools are too big, with too many of their students from deprived backgrounds. For example, at Wilson Senior High, a school perched on a hill above blue-collar East Los Angeles, the academic year started with well over 3,000 students. There are now around 2,800 (the number fluctuates as families move in and out of the district) of which some 93% are Latino, 5% Asian and just over 1% black. Only one in 200 is a non-Hispanic white. Factor in poverty (three-quarters of the students qualify for free meals) and family backgrounds in which English is often an unknown language, and academic excellence becomes an improbable target.

Add, too, the need for those Wilson students who come from central Los Angeles to get up in time for a school bus at 6.30am. Or the need to cope with pupil pregnancies (expectant mothers study in a separate annexe). Or endemic problems with drugs and gangs. No wonder, whatever the efforts of the 130-odd teaching staff, that only 29% of the students last year met the federal criterion for language and arts proficiency, and that in maths the proportion was just under 20%. It is perilously easy for any student, clever or dim, to fall by the wayside. And the same holds true in many more of the district's 858 schools, from the 431 elementary schools to the 53 senior highs.

The challenge, familiar to big-city leaders across the country, is to do something about it. Mr Villaraigosa's solution, announced last week, is to seek approval from California's lawmakers for a council of mayors from all 28 cities that fall within the LAUSD. As early as January the council would have the power over a six-year trial period to “wake up and shake up the bureaucracy at the LAUSD”, in particular by encouraging charter schools, which are free of the district's direct control. In other words, the elected school board will have its wings severely clipped and Mr Villaraigosa—because power on the mayors' council will be proportional to each city's population, and LA students make up 80% of the LAUSD—will be an education supremo on a par with Mayor Richard Daley in Chicago or Mayor Michael Bloomberg in New York.

All this might seem politically astute: Mr Villaraigosa bypasses LA voters, skirts opposition from the teachers' union and appeals directly to a legislature in Sacramento where he was once leader of the Democrat-dominated lower house. Moreover, he has the support of both Fabian Nuñez, the present Assembly speaker, and Arnold Schwarzenegger, California's Republican governor. But his plan is also potentially foolhardy. The scale of the problem is enormous; at the moment the mayor (himself a former dropout from high school) bears no direct responsibility for it, but under the new system he will quickly be held accountable for its woes.

The LAUSD establishment, including Roy Romer, the former governor of Colorado who is superintendent of the school district, believes part of the answer must be more resources. The representative of the teachers' union at Wilson, for example, says more money could go to technology, even though the school already has one computer for every eight students and, from this week, a super-fast internet connection. The principal wants more money to hire counsellors, so that there could be one adviser for every 200 students instead of every 400. Given that California ranks 44th in the nation in spending per pupil, compared with fifth in the 1960s, they have a point.

But money alone cannot be the solution. LA's voters have already approved $19 billion in school-construction bonds over the past few years, including almost $4 billion last November. Green Dot Public Schools, which operates five charter schools in poor parts of the city, points out that for every dollar of public funds the LAUSD bureaucracy manages to send only 60 cents to the classroom—instead of the 90 cents Green Dot says is feasible. What is needed, Green Dot argues, are small, autonomous schools that stay open until at least 5pm and require parents to volunteer their time. As proof, Green Dot points out that one of its schools, the 500-student Oscar De La Hoya Animo Charter School, scores substantially higher on California's academic-performance index than Mr Villaraigosa's alma mater, the 5,000-student Roosevelt High School. Similarly, 80% of ninth-graders at the Animo Leadership Charter High School go on to graduate from 12th grade.

Mr Villaraigosa is clearly persuaded: “I believe we need to abandon the one-size-fits-all approach and give educators the freedom to innovate.” The Villaraigosa vision, outlined at a successful charter school in poor south Los Angeles, stresses more charter schools (LA has 86 at the moment) “both to give families more choices and to keep positive pressure on the school bureaucracy”; more parental involvement; more school uniforms; and more after-school activities.

Great stuff, but it would be naive to count on success. The mayor is married to a teacher and is a

former organiser for the LA teachers' union—but that has not stopped the union, at both local and state level, opposing his reform plan, even though smaller classes, and subsequently a lower dropout rate, would create a need for more teachers. Mayors have taken control of schools before, notably in Chicago, Boston, Cleveland and New York, but the results have been mixed, and in Baltimore turned out to be so bad that 16 schools in 2004 were put on probation by the state board of education.

As for charter schools, they look promising, but the results so far are inconclusive. A 2003 study by the National Association for Educational Progress found that charter schools trail ordinary public schools; a Rand study last year concluded that scores in them “are keeping pace with, but not exceeding” those in traditional public schools, and do not show better results for minority students. For all the mayor's inspiring words, the odds are still depressingly long for the students of Wilson Senior High.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Denver schools

How's my teaching?

Apr 27th 2006 | DENVER
From The Economist print edition

A new and controversial approach to classroom pay

THE step is small, but a revolutionary principle lies behind it. Since the beginning of the year, Denver's school district has been running a new salary system, ProComp, which is implicitly based on a simple notion: that some teachers do their job better than others, and should be paid for it. America's teachers' unions have long considered this idea heresy, but a majority of Denver's teachers backed it after several years of pilot projects convinced them that the right kinds of performance would be measured and rewarded.

ProComp went into effect after the city's voters backed a referendum that will boost property taxes by $25m. All that money will go towards increasing teachers' pay under the new system, but the rise will only go to those who meet certain performance goals. Teachers who were already working in the school district can choose whether to enroll in the new pay system; 30% have joined so far. New teachers will not have a choice, and will be paid based on performance all through their careers.

The plan will work, says Brad Jupp—a former teacher and one of its architects—because it tries to measure several aspects of performance that, in combination, promote better learning. Instead of simply using test scores for an individual teacher's students, for example, Denver also looks at specific targets set for that teacher by the school principal. School-wide performance—measured objectively by the district—is also part of the mix, so that teachers will want to co-operate and principals will be encouraged to set high standards for them.

Besides paying more for good teaching, the new system rewards teachers who fill difficult or especially valuable positions. This includes not only working in tough schools, but also jobs, such as speech therapy or high-school maths, that have few qualified teachers and fast turnover. One reason such slots are hard to fill is because private schools and wealthy parents can pay more for teachers with rare skills who are in demand. So Denver pays them a little more to stay on in public schools. Radical stuff.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Virginia politics

The presidential double

Apr 27th 2006 | RICHMOND
From The Economist print edition

A useful indicator of how much the state has changed

IF NEW YORK can do it, so can Virginia. In Senator Hillary Clinton and Governor George Pataki, New York has produced two likely presidential candidates for 2008; but Virginia has two more. Both George Allen, the junior senator, and Mark Warner, a former governor—barely known beyond their state's borders—are gamely, if somewhat awkwardly, posturing for their parties' nominations.

Virginia was once the “Mother of Presidents”, producing eight between the late 18th century and the early 20th. After that golden age, the state—America's 12th-most-populous—seemed content to occupy the back benches. Indeed, barely 50 years ago, Virginia was a rural backwater run by conservative Democrats preoccupied with race. The state's principal export was still tobacco, as it had been when English settlers founded it in 1607.

AP

Warner, all business

Today Virginia is a politically competitive, traffic-clogged suburban dynamo. From high-tech factories up and down Interstate 95, among the busiest on the eastern seaboard, the state ships abroad more microchips than golden leaf. Over half the population are what natives once derided as “come-heres”, who were born elsewhere. The numbers of Asians and Latinos are growing rapidly. A district with a lopsided Latino plurality has sprung up in Arlington-Fairfax, a Washington, DC, suburb that was once heavily white. Not surprisingly, it makes a safe seat for Democrats in the state's House of Delegates.

Messrs Allen and Warner, who are both in their early 50s, reflect how Virginia's politics has become more like the rest of the country's. To begin with, neither is a native. Mr Allen, a conservative Republican, was born in southern California. He moved east as a teenager in the early 1970s because his father had been hired as head coach of the Washington Redskins, a football team whose fans included Richard Nixon. Although he was a surfer boy in California, the affable Mr Allen has affected the redneck for Virginians, tramping about in cowboy boots and chewing foul-smelling tobacco. Some of his views may seem equally backwoods, particularly to new Virginians: for example, Mr Allen favours sending illegal immigrants home.

AP

Mr Warner, a moderate Democrat, was born in Indiana but grew up in Connecticut. He landed in Virginia because it is next-door to Washington, where he dabbled as a political operative and later amassed a fortune from an early, lucky bet on mobile phones. His style is that of an edgy yuppie businessman, more interested in deals than ideology. He also speaks fluent Spanish, an advantage

in a state where divisions are now more linguistic than racial.

Allen, all backwoods

Although Mr Allen has been in the Senate since 2000, he served as governor from 1994 to 1998. His administration and Mr Warner's, from 2002 to 2006, covered a decade during which Virginia swung from sharp partisanship to uneasy bipartisanship, and from an emphasis on such racially tinged issues as prisons and welfare to the colourblind challenge of paying for them.

On Mr Warner's watch, this meant pushing for, and winning, the seemingly unthinkable in 2004: a $1.4 billion tax increase for schools, police and social services. But he was rewarded with record approval ratings that assured the election last November of another Democrat as governor and stoked Mr Warner's appetite for higher office. Virginia's voters are a prosperous and well-informed lot; two out of three hold white-collar jobs, and one in three is a college graduate. They are therefore inclined to view taxes benignly, as public investment. The state, after all, still has a relatively modest per capita tax burden, ranking 41st among the 50 states.

Mr Allen, by contrast, fancies himself as an anti-tax hawk. The right wing of his party likes that, as it does his opposition to abortion, his difficulties with homosexuals and his near-blind allegiance to George Bush on Iraq. The newer sort of Virginians, however, see him as an inflexible partisan. As he balances his Senate re-election campaign with his drive for the presidency, Mr Allen may discover that the issues dear to the conservative core of his party mean little to Virginians in general.

Mr Warner has the opposite problem. His centrist opinions—for the death penalty, for some abortion restrictions, against gay marriage, against further gun control—endear him to Virginians but put him outside the mainstream of the national Democratic Party. Still, he views himself as the anti-Hillary, positioned to snatch the nomination if Mrs Clinton stumbles.

It seems that Mr Warner could have run a different race, for Mr Allen's Senate seat. Polls show he would now win it easily, though in 1996 he failed in a Senate bid. But he might have found himself in the same sad situation described by Mr Allen in a recent interview with the *New York Times*: running for president to escape the sheer boredom of Senate life.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Refugee policy

Less hope, a longer wait

Apr 27th 2006
From The Economist print edition

America is treating more refugees as terrorist suspects

JUST as the United Nations Refugee Agency (UNHCR) is reporting that the world's refugee population has fallen to 9.2m, the lowest for 25 years, the agency has also sounded a note of alarm. Some governments, it says, are indifferent or intolerant towards those still in need: refugees, asylum-seekers and those internally displaced within their own countries. Among the offenders is the government of the United States.

America may seem an unlikely target. It typically accepts about half the refugees the UNHCR resettles, well ahead of Canada and Australia. Yet the Bush administration is currently the subject of intensive lobbying by refugee advocates, who say it is muddling America's humanitarian and security interests.

A shift of policy means that America now denies entry to those deemed to have provided “material support” to terrorists. The idea sounds sensible, since every week brings evidence that the terrorist threat is as potent as ever. In practice, though, vague wording in American legislation—particularly the USA Patriot and Real ID Acts—has led to what critics call a new and over-broad interpretation of the provision by officials at the Departments of Justice and Homeland Security. While Congress and various agencies wrangle over the issue, the resettlement of thousands has come to a standstill—though they may be victims of terror themselves.

Already, the “material support” bar has disrupted resettlement for 750 Colombians and more than 10,000 ethnic Chin and Karen from Myanmar, now living in camps in Malaysia and Thailand. The fates of Cubans, Liberians, Somalis, Vietnamese Montagnards and more than 500 asylum-seekers awaiting processing in America are also in jeopardy.

Some of the most striking cases involve victims of and witnesses to rape, torture or murder who provided food or shelter to their tormentors under duress—and are now being rejected by America for giving this support. Other affected refugees gave help to groups that do not appear on America's lists of terrorist organisations, and oppose the same regimes America considers hostile.

An example is the Karen National Union (KNU), a rebel group opposing the military government of Myanmar. In the past, says one UNHCR official, “you would have almost had to be a supporter of the KNU to be admitted” as an ethnic Karen into the United States. Now its adherents are barred. “Everything is tinged with the national security perspective”, laments Jenny Hwang of World Relief, a humanitarian group that helps refugees.

After months of intensive lobbying, refugee advocates saw progress on April 26th when an amendment was added to a foreign appropriations bill sponsored in Senate committee by Patrick Leahy and Norm Coleman. The bill, which has yet to be voted on by the full Senate, would define “terrorist organisations” more clearly, thereby protecting groups in Myanmar and Cuba from being

tarred with that brush. It also recognises the cases of refugees who provided support only under duress, and eases the burden on them.

Meanwhile, the other side of the coin cannot be forgotten. The recent arrest in Phoenix of some Bosnian Serbs under investigation for war crimes is a reminder that not all those seeking new lives in America are victims.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The White House reshuffle

Snow job

Apr 27th 2006 | WASHINGTON, DC
From The Economist print edition

The new press secretary thinks George Bush is a dime-store Democrat

WILL he get back-pay? This reaction to the announcement that Tony Snow is leaving Fox News to become George Bush's press secretary was perhaps predictable. Fox News is the voice of Republican America—the brain-child of a former Republican operative, Roger Ailes (who also dreamed up the malicious slogan “fair and balanced”), and the channel of choice for Republicans everywhere. Vice-president Dick Cheney insists that hotels tune his television to the Fox News channel.

But the charge is slightly unfair. It turns out that Mr Snow is more loyal to the conservative movement than to the man in the White House. No sooner had the announcement been made than various liberal groups started circulating some of the choicest things that Snow-the-journalist had said about his new boss. Mr Bush is a “dime-store Democrat” who has completely “lost control of the federal budget”. He is “more eager to please than to lead”. He does not have “the drive and work ethic to succeed”. He speaks like “a soul tortured with Tourette's”. He is “something of an embarrassment”. His domestic agenda is “listless”.

So why did Mr Bush appoint Mr Snow to the job? One reason is that he wants to rebuild his credibility with the press. Mr Snow's predecessor, Scott McClellan, began his job with little respect from the media and ended up with zero; Mr Snow is a much more substantial figure, a veteran of print, television and radio. Another reason is that Mr Bush wants to rebuild his credibility with the only people that he has left on his side: the conservative movement. Conservatives are delighted that they now have one of their own in the press office.

But the most important reason is shortage of choice. At this stage in the game it is hard to find sentient beings in the country who haven't expressed some sharp opinions on the president. “You should have heard what I said about the other guy,” was Mr Snow's way of dealing with those quotations.

The more interesting question is why Mr Snow, who only recently recovered from colon cancer, accepted what must be the most thankless job in America. The Republicans are as depressed as the president's ratings. Karl Rove, the president's chief political adviser, has just testified before a grand jury for the fifth time in the Plame affair, a hint of more trouble to come. Mr Snow risks straining many of his friendships both in the media and the conservative movement. So why did he accept? Partly because he has a history as a White House insider: he worked for the first president Bush as director of speechwriting and deputy director of media affairs. Partly because he persuaded Mr Bush to give him a bigger job than his predecessor. He will have a “seat at the table”, including input into policymaking and “walk-in” privileges with the president. But largely because few people can resist being on the inside of even a crumbling administration. The business of Washington is power, and there is no better place to experience it than standing at the president's side—even if you do think that your boss has a bad case of Tourette's.

Presidential legacies

Dude, where's your library?

Apr 27th 2006 | DALLAS
From The Economist print edition

Texan universities are vying to display George Bush's golf clubs

IN COLLEGE STATION, a quarter of a mile up Barbara Bush Drive on the outskirts of Texas A&M University, a huge concrete edifice replete with American flags announces the George Bush Presidential Library and Museum. Inside, as patriotic music softly plays, starry-eyed visitors revel in the bric-à-brac of the 41st president: his fishing rod and Yale baseball mitt; Barbara's designer gowns; a model of the sub that plucked Lieutenant Bush from the ocean after he was shot down in 1944; and much else besides. There is lavish praise for everything that George Bush senior did, and even some kindly words for his hapless vice-president, Dan Quayle.

Presidential libraries are good at puffing up reputations, and this is something that George Bush junior badly needs right now. A decision on where his library will find a resting place is expected any day soon. Texas is abuzz with speculation. Southern Methodist University (SMU) in Dallas is seen as the front-runner. Also in with a chance are Baylor University, in the dreary town of Waco, and the University of Dallas. Two other Texas universities were eliminated last month.

Reuters

One for the shelf

SMU, set in an elegant, tree-lined district of Dallas, has solid White House connections. Laura Bush, later a librarian, was Class of '68, and she still sits on the university's board of trustees. The Bushes are also members of a nearby church. Other eminent alumni include Harriet Miers, the White House counsel once nominated for the Supreme Court, and Karen Hughes, the under-secretary of state in charge of the president's international image.

But SMU is battling a lawsuit that could be related to where the library goes. Two condominium owners are suing the university for trying to force residents out by declaring the condos obsolete. “The library is coming right here,” says Gary Vodicka, one of the litigants, as he wanders around the mostly-deserted residences. A spokesman for SMU, which has not yet disclosed exactly where it wants to put the library, insists that the lawsuit has nothing to do with the library proposal.

The lucky campus that eventually becomes host to Mr Bush's legacy will be hoping for a windfall. The model is Bill Clinton's library in Little Rock, which opened in November 2004. Despite being

ridiculed for “trailer-home chic” architecture, the library saw attendance in its first year soar to more than 500,000—well above the projected 300,000 annual visitors. Put another way, that is nearly three times the population of Little Rock.

Skip Rutherford, head of the Clinton Library Foundation, gives credit to the site; the library is visible from Interstate 30, and an easy drive from Memphis. Built in a warehouse district for $165m, it has paid off handsomely, already bringing $1.2 billion in economic development to the city. The Bush library may cost more. There are reports that a bid led by Texas Tech (one of the universities to be eliminated) promised to raise $500m for the project, though $200m-300m seems more realistic. Mr Rutherford advises Mr Bush's would-be hosts to “do whatever it takes to get it”.

The Dallas press is gleeful at the prospect of a George W. library. In a column last month, Steve Blow of the *Dallas Morning News* reckoned that the exhibits would include “The Frat Boy Years”, “The Failed Business Years”, “The Figurehead Baseball Job”, “Cool, I'm Governor!” and “Holy Crap, I'm President!!”. As for the archives—a mainstay of every presidential library—he predicts that just about everything will be classified.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

New York's Hasidic Jews

In God we tussle

Apr 27th 2006 | NEW YORK
From The Economist print edition

A rabbi's death and a fierce succession battle between his sons

VISITORS to Williamsburg, in Brooklyn, are transported to another century. Just a few blocks south of streets alive with insouciant artists and Puerto Rican immigrants, the men in Williamsburg wear long beards, long gaberdines and black hats; the women are modestly dressed in long skirts and sensible shoes. Children evoke an innocence rarely seen outside sepia photographs. The neighbourhood looks like a perfectly preserved Jewish ghetto from the late 18th century. As the seat of the Satmar Hasids, one of the world's largest and fastest-growing sects of ultra-Orthodox Judaism, it is in many ways just that.

Reuters

Mourning one leader, needing another

The Satmar sect was founded in Satu Mare, Romania, then part of the Austro-Hungarian Empire. Its followers moved to America after the second world war, forming a small, anti-Zionist community that included Holocaust survivors. The sect has since grown to some 100,000 members worldwide, between 65,000-75,000 of whom live in America, 95% in New York.

The group may be culturally isolated, but few New Yorkers can now be ignorant of its leadership woes. On April 24th the Satmar grand rabbi (or *rebbe*), Moses Teitelbaum, died at the age of 91, leaving behind a revered legacy, thousands of mourners who jammed the local synagogue for his funeral three hours later, and a fierce, unseemly succession battle. Two of his sons, Aaron and Zalmen, both rabbis in their 50s, have spent the past five years feuding over which of them should be the next *rebbe*. At stake is not only the spiritual guidance of the community (the *rebbe* is believed to commune directly with God), but a religious empire worth over $500m in schools, businesses and property.

The problem dates from 1999, when Moses Teitelbaum made his third son, Zalmen, the head of the sect's main congregation in Williamsburg. This came years after he had put Aaron, his oldest

son, in charge of the second-largest congregation in Kiryas Joel, 70 miles (113km) north of New York City. Zalmen's supporters argue that the *rebbe*'s decision to make him leader of the Williamsburg base implied a desire for him to assume the spiritual throne. Aaron's backers responded by attributing this decision to the *rebbe*'s allegedly severe dementia. The brothers have been locked in rivalry over board elections and in sordid legal manoeuvrings in three state courts. Their supporters have even come to blows: in late October nearly 100 policemen had to break up a punch-throwing, beard-pulling riot of some 1,000 Satmars.

Though the grand *rebbe* never weighed in while he was alive, he did anoint a son, Zalmen, in his will. According to an announcement by the Satmar's Rabbinical Court on April 25th, the old man wrote “Effective immediately I have granted him the position.” Clear enough, perhaps, but it has not settled the issue. Aaron's supporters now argue that the next *rebbe* must be chosen by the Satmar Board of Directors. Lawyers for both sides predict that the case could end up in the Supreme Court.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Hawaii

Sacred or profane?

Apr 27th 2006 | HONOLULU
From The Economist print edition

A rumpus over neonatal traditions

TO CONNECT a child to its birthplace, and to ensure the health of both child and mother, the mother's placenta or *'iewe* should be buried. So says Hawaiian lore, and with the growth of interest in traditional customs, the practice of burying the placenta has become more common on the islands. But last summer, the state's Department of Health declared the placenta to be "infectious waste" and ruled that hospitals should not return it to new mothers.

Concern about the spread of HIV to health-care workers led in 1990 to state rules governing the handling and disposal of potentially infectious waste. Amniotic fluid, plasma, and other bodily substances were explicitly mentioned, but afterbirth was not. As a result, hospitals and clinics throughout Hawaii had a surreptitious policy under which the delivering doctor would arrange with the parents to return the placenta in a cooler or other container without consulting the Health Department.

This easy-going attitude changed last June when two parents, Nohea Stibbard and Kihei Nahalea, asked the Kaiser Medical Centre in Honolulu for their baby's placenta and the administrators at Kaiser contacted the Department of Health about the proper procedures. The director of DOH delivered her own interpretation of the ruling, declaring the placenta to be "infectious waste" that should be discarded. The parents filed a lawsuit in federal court. Other parents were subsequently denied their placentas; one family's *'iewa* is in a freezer in a local hospital, and a second lawsuit is pending.

But the DOH's ruling and the subsequent fuss had goaded the legislature into action. A bill was passed by both houses, and was signed into law by the governor on April 21st. This will allow mothers, or someone chosen by the mother, to take away the placenta so long as it has tested negative for both HIV and hepatitis. The law also calls for more general administrative rules on the placenta to be formulated.

The DOH maintains that despite the change in the law, it still considers the placenta to be "infectious waste". "We would make an exception for these cultural practices, but it is still a practice we would urge caution with," says Janice Okubo, a department official. But Annelle Amaral, director of public affairs for Planned Parenthood of Hawaii, is delighted."This is about cultural practices and religious freedom," she says. "With this [bill], these *'iewe* can be released to the parents, go into the earth, and complete the cycle."

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Lexington

Premium pressure

Apr 27th 2006
From The Economist print edition

George Bush fails to defend an inalienable right: cheap petrol

YOU know something is afoot when Ted Kennedy and Bill O'Reilly start singing together. The senior senator from Massachusetts and the pundit-in-chief of Fox News can usually be relied upon to produce nothing but discord. But when it comes to rising prices for gas—petrol, as Brits insist—they are in perfect harmony. Americans are being ripped off at the pump! “Greed-heads” are manipulating the market and gouging the little guy! Something must be done!

Such sweet agreement spells big trouble for George Bush. There is a lively debate in America as to whether the “penumbras” and “emanations” of the constitution include the right to abortion. But, as Steven Hayward of the American Enterprise Institute points out, there is no debate as to whether these penumbras and emanations include the right to cheap petrol. Americans are convinced that the rising price of petrol—the average price of a gallon has reached $2.90 and some places are charging more than $3—is nothing less than a violation of the rights they won from George III; and they have no doubt that the people doing the violating are the oil companies. Aren't the oil companies making record profits? And didn't the chairman of Exxon, Lee Raymond, just get parting “compensation” worth about $400m? “Does everybody love Raymond?”, asks Mr O'Reilly. “I don't. I think he's a greed-head.”

You can quibble for as long as you want about the economics of all this. You can point out that the price of petrol is fixed by global forces—from rising demand in India and China to political instability in Nigeria and, particularly, Iran—rather than devilish CEOs. You can point out that, so

far, rising petrol prices have had remarkably little impact on the economy. The oil shocks of the 1970s sent inflation soaring and tipped the world economy into recession. Today the American economy is motoring along on a full tank, with low inflation, low unemployment and rising consumer confidence. You can point out that Americans don't know how lucky they are—a gallon of petrol costs $6.4 in Britain. You can even argue that it is their fault for driving gas-guzzling SUVs and living in McMansions miles from anywhere.

But you might as well hold your breath for all the difference it makes. No less than 69% of Americans think that the rise in petrol prices has already caused them either severe (23%) or moderate (46%) hardship. Nearly two-thirds think that the president has a lot of influence over the price of petrol. The result is that a presidency that has already been battered by Hurricane Katrina and bruised by the Iraq war is being bombarded by soaring petrol prices. Mr Bush's approval ratings are at an all-time low of 32%; economists are warning everyone that the price of petrol will rise higher as the summer driving season starts; and pundits are suggesting that Mr Bush may be a Republican Jimmy Carter, destroyed by Middle Eastern terrorists and rising oil prices. All he needs is a cardigan and a liking for the word “malaise”.

The Democrats have seized the opportunity to bash Big Oil with predictable relish. Herb Kohl, a senator from Wisconsin, has introduced a bill to prevent petrol companies from colluding to keep prices high. Big Oil has “unquestionably enriched itself during this period of high prices,” he says. Carl Levin, a senator from Michigan, has urged Mr Bush to impose a windfall tax on the oil companies' “obscene profits”. On April 20th the Democratic Congressional Campaign Committee recommended that candidates for office hold campaign meetings at petrol stations—and pledge that as members of Congress they will “fight for families...not the oil and gas executives”.

And those stalwart friends of big business, the Republicans? Naturally, they have fired a few shots at the Democrats. How can the Democrats have the nerve to complain about rising petrol prices when they have systematically blocked attempts to increase the production of oil? And when they want to bring in “green” taxes that will push the price of petrol much higher? But for the most part they have contented themselves with me-too company bashing. Bill Frist and Dennis Hastert, respectively the majority leader in the Senate and the speaker of the House, have called for an investigation into “price fixing” and “gouging”. Arlen Specter, a senator from Pennsylvania, is also talking about a “windfall-profits tax” and an antitrust investigation. Other Republicans have threatened to summon oil executives to Capitol Hill for a grilling.

Low presidential reserves

The best that can be said for Mr Bush is that he has avoided making obvious mistakes. He was much faster off the mark than he was over Katrina, delivering several speeches on the subject of high petrol prices. He produced a four-point “practical plan”, which at least gives the impression of activity. And he sounded the right populist notes about fighting fraud and manipulation and depriving oil companies of some of their tax breaks. But his speech was essentially bluster and hot air. What he offered was a combination of empty gestures (calling a temporary halt to feeding the strategic petroleum reserve, when deposits to the reserve are less than 30,000 barrels a day in a country that consumes 21m barrels a day) and sensible ideas that will take decades to have any effect.

Most of Mr Bush's disasters are largely his own creation: Iraq because he chose to invade the country, Katrina because he ignored the warnings beforehand and was lamentably slow to respond afterwards. But petrol prices are different. Mr Bush can't rig the international oil markets. He can't pretend that his administration is not top-heavy with oil men. And he can't change the subject, particularly as the summer driving season approaches. The Bush family has reaped more than its fair share of benefits from Big Oil over the years. This summer, it is proving a dangerous friend to have.

The Brazilian Amazon

How green was my valley

Apr 27th 2006 | SÃO PAULO
From The Economist print edition

Brazil struggles to put the brakes on rampant deforestation without throwing tens of thousands of loggers and farmers into poverty

Reuters

Get article background

“MONSTROUS misery and hunger.” That is the lot of people dwelling in the Amazonian state of Pará since Brazil's government cracked down on loggers and others who earn their livelihoods in the rainforest, says Luiz Carlos Tremonte, who heads a loggers' union. Businesses are idle, thousands are losing their jobs, food aid has not come. The loggers' suffering is no cause for celebration, but to environmentalists the government activism that gave rise to it is.

Brazil loses an average of around 20,000 square kilometres (nearly 8,000 square miles) of rainforest every year. This is because the state lacks the will and the means to control loggers and—more importantly—ranchers, farmers and landgrabbers. This may now be changing. In the year to last August, 19,000km^2 of rainforest were destroyed, almost a third less than the 27,000 the year before. “The idea of any country controlling what goes on along an agricultural frontier is completely new,” says Stephan Schwartzman of Environmental Defence, an American NGO.

There are reasons to be wary. Last year's lower rate of deforestation means that the Amazon lost a Kuwait-sized slab of forest rather than nearly a Belgium's worth. This was partly because of a drop in soya and beef prices, the main motors of destruction; when prices bounce back, so may deforestation. The federal government's green contingent is an insecure minority that could be out

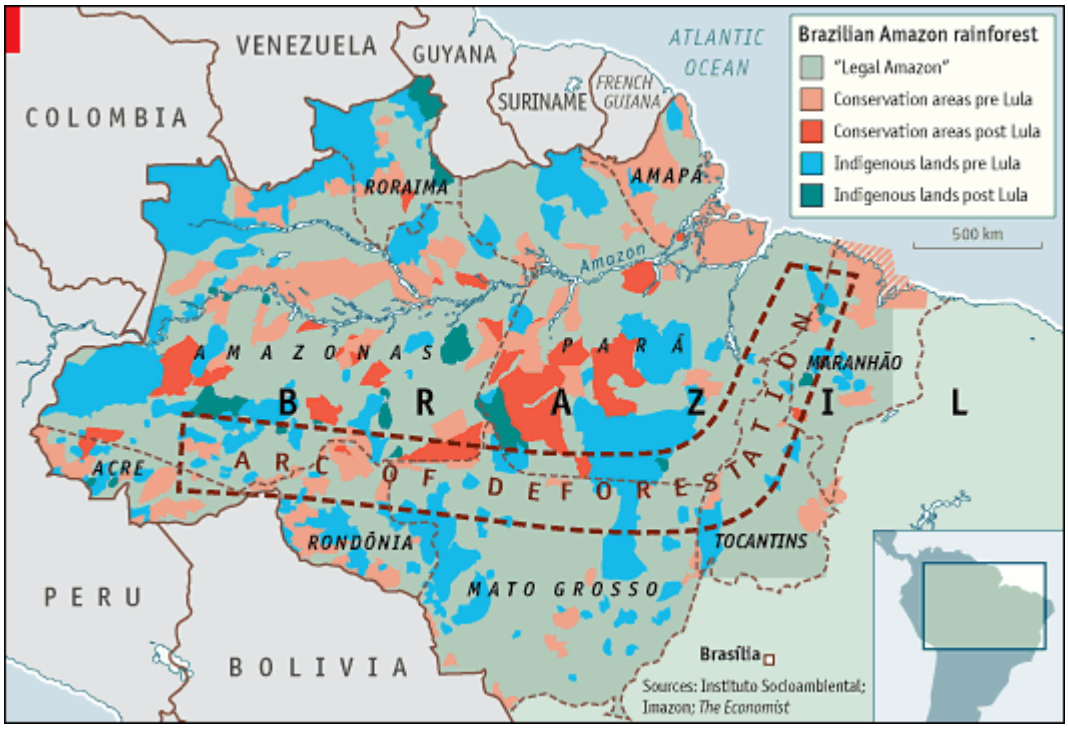
of office after next October's presidential election. Environmentalism in state governments is even shakier. Yet enough is changing in the way government deals with the Amazon—including new conservation reserves, a new forest law and tougher enforcement—to hope that this marks progress rather than merely a pause in the destruction.

The idea that the Amazon needs saving is relatively new. Mr Tremonte points out that the government once summoned Brazilians to the region to "*integrar para não entregar*" (integrate the Amazon into Brazil to save it from falling into foreign hands). It remains largely isolated—the main thoroughfares are dirt tracks—but not intact. Nearly 40% of the "legal Amazon", covering all Amazonian states, consists of protected areas, such as national parks and "indigenous" (Indian) reserves. A quarter is private property, which is supposed to be kept 80% forested but often is not. Most of the rest is unprotected "empty land", nominally federal property but prey to speculators who assert their claims by despoiling it. Lack of effective ownership often provokes violence: in February 2005, Sister Dorothy Stang, an American nun, was murdered by landgrabbers in Pará.

That prompted the government to send in the army. More effectively, Brazil's president, Luiz Inácio Lula da Silva, has created 150,000km^2 of new conservation areas. Earlier reserves were concentrated in remote areas with little attraction for developers. The newest ones stand athwart the "arc of deforestation"—a great swathe of agricultural development, some 400km wide and 3,000km long, that has eaten into the forest—in the hope of discouraging further incursion.

Presidential decrees alone will not disrupt the Amazon's illicit economy, let alone implant a law-abiding and forest-friendly one. That will come from the combined effect of new laws, police operations, regulatory tinkering, institutional reform and pressure by NGOs. Something is happening in most of these areas.

Last year, federal police arrested 148 people in the high-deforestation states of Mato Grosso and Rondônia, a third of them employees of Ibama, the corruption-riddled federal environment agency. Loggers are screaming because the government suspended 3,000 licences to harvest wood on public land. *Protocolos*—official recognition of a land claim—are now being issued as bar codes rather than as documents similar to title deeds that can be sold or used as collateral for bank loans. That short-circuited the trade in *protocolos*, a prime tool in land grabbing. As a result, 600,000km^2 of land claims have disappeared, says Tasso de Azevedo of the federal environment ministry.



Mato Grosso is better equipped than most states to control deforestation, with a state-of-the-art system for licensing properties and satellite technology to monitor its use. After a purge of the state environment agency, the system is now working well, says André Lima of Instituto Socioambiental, an NGO. But in the areas of enforcement and transparency, there are still problems. Fines are not being paid, nor has the state government put deforestation data on the internet. To encourage enforcement, a group at the Federal University of Mato Grosso plans to report on cases against the 60 largest deforesters.

A federal law passed last month “will change the rationale that leads to deforestation,” says Mr de Azevedo. Under the law, empty land will be preserved as “public forest”. Part of this—due after ten years to total about 3% of the rainforest—will be handed to forest-friendly companies through concessions; 6% will be reserved for harvesting by communities; and 12% will be turned into new conservation areas. A new forest service will manage the concession contracts; private certifiers will check that firms and government agencies are doing their jobs. Mr de Azevedo sees in this the end of a 500-year tradition of seizing and razing the forest.

But this vision is still a long way from being realised. A judicial and political backlash is likely. Despite provisions for “sustainable” forestry, Mr Tremonte is convinced that the government wants to drive loggers out, while Greens grouse that it is not doing enough. Although the environment ministry is eager to control the frontier, other ministries seem unenthusiastic. A recent bailout of struggling farmers, for example, did not require that they obey the environmental law. On the rescue of the Amazon, the government is clearly still of two minds.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Tropical rainforests

Giving credit

Apr 27th 2006 | SÃO PAULO
From The Economist print edition

Rewarding rainforest conservation to help global warming

Get article background

TROPICAL deforestation accounts for a fifth of greenhouse gases emitted by human activity. Yet the Kyoto protocol, which seeks to control global warming, does nothing to discourage it. Carbon credits will be available for planting new forest but not for preserving what is already there. This may change. At a climate meeting in Montreal in November, nine rainforest countries, led by Papua New Guinea and Costa Rica, proposed that countries that reduce deforestation below a given baseline be eligible for carbon credits, which others could then “buy” instead of cutting their own emissions.

The idea seems to be gaining diplomatic traction. It would be a way to set voluntary targets for developing countries, which are now exempt from Kyoto's emission caps. That might encourage rich countries to accept new targets after the current ones expire in 2012. Hard as it is to reduce deforestation, it is easier than changing the way economies burn energy.

Brazil, which had flatly rejected payments for avoiding deforestation, has softened. It has said it will consider incentives, though not carbon credits (which would compete with the nascent business of selling other carbon-reduction projects through Kyoto's “clean development mechanism”). IPAM, a Brazilian research institute that is pressing for another scheme for using carbon credits, calculates that the country could earn nearly $500m a year from them. That would go a long way toward paying for conservation of the Amazon.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Haiti's elections

Tiptoeing toward stability

Apr 27th 2006 | PORT-AU-PRINCE
From The Economist print edition

Mr Préval is set to form a government

IN A further boost for much-needed political stability in Haiti, parliamentary elections last week passed off without incident. Although turnout was low—around 30% of the 3.5m voters—that hardly mattered compared with the relief over a day free of fraud or violence in a country so recently emerged from dictatorship and civil conflict. Haiti's previous parliamentary elections, in 2000, were marred by massive fraud, provoking a violent political struggle that ended in the ousting of President Jean-Bertrand Aristide in 2004.

Presidential elections in February, supervised by the UN, were again nearly derailed by allegations of fraud. But René Préval, a popular 63-year-old agronomist, was eventually confirmed the winner. Partial results from last week's legislative run-off indicate that although his party has failed to win an absolute majority, it is set to win enough seats in both the upper and lower houses for Mr Préval to form a coalition government, led by a prime minister of his choice. Partial results show Mr Préval's Lespwa (Hope) party winning at least 11 of 27 seats in the Senate, and at least 20 of 85 seats in the lower house.

Mr Préval should have no problem forming a coalition. He will have the biggest voting block in both houses, and all the parties say they will support him. Mr Préval is due to be sworn in as president on May 14th, three months after his election. Political analysts say he has used the lengthy transition period wisely, reaching out to all sides to heal the bitter political divisions that have plagued the hemisphere's poorest country for so long.

In the last few weeks he has also made a series of successful foreign trips to Washington, Brazil, Cuba and Venezuela. It has been a while since Haiti could boast a statesman at the helm, and that has clearly boosted Lespwa's credibility with voters. Mr Préval returned this week from Caracas, with an agreement from President Hugo Chávez for Haiti to join a Venezuelan oil pact that supplies Caribbean countries with cheap fuel. Cuba has offered continued medical aid, and Brazil is sending experts to explore the development of bio-fuels, such as ethanol.

America appears unfazed by Mr Préval's dealings with Cuba's President Fidel Castro and Mr Chávez. As long as Haiti sticks to a democratic path, it seems happy to let anyone help prevent the country reverting to chaos.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Racial politics in Guyana

Good hopes and bad intentions

Apr 27th 2006 | GEORGETOWN
From The Economist print edition

A brutal political assassination

SHORTLY after midnight on April 22nd, in the village of La Bonne Intention just east of the capital, Georgetown, a squad of masked gunmen, armed with assault rifles, burst into the home of Guyana's well-liked Indo-Guyanese agriculture minister, Satyadeow Sawh. He was shot dead, along with his sister, his brother, and an unarmed security guard. The killers took $115 and a cheap watch. The attack is being treated as a political assassination—the first in north or south America since 1993. President Bharrat Jagdeo described it as “an attempt to destabilise our democracy” ahead of this year's general election.

Even before the killings, Guyana was edgy, racked by racial and political divisions, drug-trafficking, and gun crime. About 43% of the former British colony's 750,000 inhabitants are descended from Indian indentured labourers; 31% from African slaves. The ruling People's Progressive Party-Civic (PPP-C), mostly supported by the Indo-Guyanese, has been in power since “free and fair” elections were introduced in 1992. Before that, the rival People's National Congress-Reform (PNC-R), supported by most blacks, clung to power for 28 years, thanks to a series of blatantly rigged polls. Now in opposition, it claims itself to be the victim of electoral fraud.

In Guyanese politics, squabbles over electoral technicalities have long outweighed policy issues. After the 1997 elections, protests over irregularities boiled over into riots and massive public-sector strikes. This year, a row over electoral lists has split the Elections Commission. And the general election, due under the constitution to be held by August 4th, has had to be postponed until later in the year, because of further technical hitches.

But until last week's killings, the electoral climate had seemed less fraught than usual. A shift in the ethnic balance may bring the opposition a few extra seats, so it has greater reason to make elections work this time. Indeed, the pre-poll skirmishing had begun to look like a ritual dance rather than anything more sinister.

An earlier series of high-profile crimes had raised tensions, but they have proved difficult to decode. In January, Ronald Waddell, a black television talk-show host and fierce critic of the government, was shot dead. His show had been dropped three months earlier, after he described black gangs in the country's main crime hotspot as the “Buxton resistance”, who were defending “the African nation in Guyana”. But he was not widely popular, and neither party seemed to gain from his death. In February, gunmen killed eight people in the predominantly black village of Agricola, south of Georgetown—again for no obvious reason. Two of the guns fired were later used to kill Mr Sawh and his family.

Politically motivated criminal gangs with links to the drug trade are the most likely assassins. Guyana's thinly populated interior is a staging post for Colombian cocaine. America's annual

narcotics report, published last month, suggests that drug money represents as much as a fifth of Guyana's economy.

The PNC-R and PPP-C are old enemies, but neither wants to see anarchy. The two parties are now talking again. On April 25th, Mr Sawh was given an open-air Hindu cremation at the village of Good Hope. Through the pouring rain, a shaft of sunlight made a small rainbow.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Cuba

Fidel, the electrician

Apr 27th 2006 | HAVANA
From The Economist print edition

A battle against power cuts

“MEGAWATT” is a word that pervades Fidel Castro's speeches these days. The Cuban president's lengthy diatribes are now just as likely to dwell on the technical specifications of light bulbs and electricity generators as on more familiar themes like Cuba's “imperialist” foe to the north. For his audiences, often packed with children, it is hard to look interested. But they must. For Mr Castro has declared this to be “the year of the energy revolution”. He has vowed to end by May 1st the power cuts that have started to test the legendary patience of the Cubans.

To do so, the state-controlled media reports, the government is importing no less than 4,158 electric generators, many about the size of a standard cargo container, at a cost of around $800m. Some will serve hospitals, factories or schools directly. Others will be plugged into the sagging national grid, currently served by seven big power plants, most using antiquated Soviet technology. Notoriously unreliable, they rarely work at more than 60% of capacity. This is partly because of a shortage of spare parts, and partly because for the past 15 years they have run on locally produced sulphurous diesel and need almost weekly cleaning.

In the summer, when Cubans switch on electric fans—or, for a lucky few, air-conditioning—the system cannot cope. To make matters worse, hurricanes last year blew down hundreds of transmission towers, leaving millions of Cubans without power. This prompted a few, rare, protests as well as anti-government graffiti, one showing Mr Castro with an electrical cable protruding from his behind. It is virtually unprecedented for Cubans to mock their leader, in public, in this way.

Mr Castro did what he often does in times of domestic unease: he recast himself as leader of the opposition, scolding officials of the state-run electricity co-operative on television. In 2004, after a particularly bad spate of blackouts, the minister of basic industry was sacked. The fact that he was married to Mr Castro's niece did not save him. Since then, Mr Castro has micro-managed the issue himself, personally negotiating the purchase of the generators. Thanks to his alliance with Hugo Chávez, he now has cheap Venezuelan oil with which to run them.

In the short term, the generators may bring some relief. But there are pitfalls ahead. All will require regular fuelling and maintenance, as well as synchronisation with the national grid. Their components may be stolen too. To reduce electricity demand, Mr Castro is instigating an energy-saving campaign. Thousands of young “social workers”, the regime's new shock troops, are going house-to-house across the island, installing low-energy fluorescent bulbs. Electricity tariffs are being raised, especially for those who consume most. Cuba is setting a green example to the world, the president declares.

Long assured that they enjoy a superior political system, Cubans now just want what almost nine out of ten other Latin Americans already enjoy: reliable electricity at the flick of a switch.

China

Struggling to keep the lid on

Apr 27th 2006 | BEIJING
From The Economist print edition

The economy just grows and grows

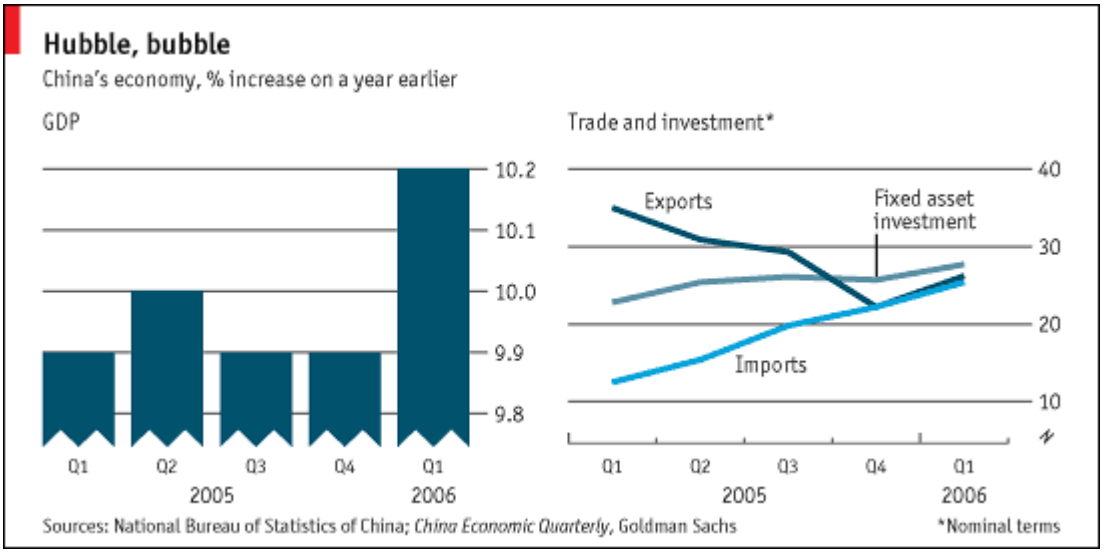
JUST when many were predicting a gentle easing of China's economic growth this year, figures for the first quarter suggest the opposite. Driven by a surge of investment and easy credit, the economy grew by 10.2% year-on-year, even faster than last year's annual rate of 9.9%. Now officials fret that it is close to overheating. On April 27th, the central bank raised interest rates for the first time in 18 months, by 0.27%, and announced “guidelines” to control lending to a dozen industries. As *The Economist* went to press the details of these were not clear, but there was speculation that further measures would be forthcoming in the near future.

There was much for the authorities to be anxious about. GDP growth in the first three months compared with the same period a year ago was the highest quarterly rate since at least 2004 (data revisions make earlier comparisons difficult). That was the year in which China began trying, with limited success, to put on the brakes. Investment in fixed assets, such as roads, factories and machinery, surged by 27.7%. In urban areas it grew by 32.7%, year-on-year, in March alone. The government had been hoping to keep growth in such investment to 18% this year, down from 27.2% last year. And in that same first quarter, China's state-owned banks lent nearly as much money—1.26 trillion yuan ($157 billion)—as the government had targeted for half of the year (see article). The broad money supply grew by 18.8%, up by 4.7 points over the same period last year and higher than the central bank's target for 2006 of 16%.

China's trade surplus continued to grow briskly too, rising to $23.3 billion in the first quarter, with exports up by 26.6% and imports by 24.8%. This was 41% bigger than the surplus of January to March last year. This will hardly help to ease concerns, particularly in America, that China is profiting unfairly from an undervalued currency. On the strength of the latest figures, this year's trade surplus may not be far off last year's record of $101.9 billion.

China's leaders relish high growth and flourishing export-oriented industries. They help generate employment in a country where the urban jobless rate is estimated at more than 8% (far higher in some cities), and where at least 150m people in the countryside have little or nothing to do. Much slower growth could pose a threat to social stability. But they worry that the current high rate is being sustained by irrational and resource-wasting investment. This could further weaken the bad-debt burden of state-owned banks and eventually result in an abrupt and painful slowdown as credit dries up.

So why is it proving so difficult to engineer the “soft landing” that the government has been trying for? This year's GDP growth target is 8%. Even before the latest figures were announced, this appeared conservative. Many economists have now revised their estimates upwards. The Chinese Academy of Social Sciences, in its latest report, predicted growth this year would be only fractionally slower than last year's, at 9.6%. Its last quarterly report said it would be around 9%.



China's exchange-rate policy is part of the problem. In recent months the country has been awash with cash. The trade surplus leads to large inflows of foreign currency, which is bought up by the central bank in order to hold down the exchange rate. But this boosts the supply of yuan deposited in banks.

The central bank usually curbs this money-supply growth by borrowing back much of the excess yuan. But Stephen Green of Standard Chartered Bank says that, for a few months in the middle of last year, it relaxed these efforts to offset the potential impact of an upward revaluation of the yuan in July. The result was a surge of cheap credit. This will inevitably mean bad news for the banks when some of these loans eventually turn bad. In the first quarter, industrial profits rose by 21.3%, but losses by 32.3%. With huge oversupply in some industries, and big rises in raw-materials costs, many manufacturers are having to endure wafer-thin margins.

Although efforts to rein in the money supply resumed in October, investment grew rapidly as local governments, heedless of central efforts to tame the economy, raced to boost local growth rates. This was encouraged by the launch this year of their new five-year economic plans, traditionally a

time for starting big new projects. Many local five-year plans project double-digit annual growth rates, even though the central government is aiming for a modest average of 7.5% until 2010.

To help reduce net foreign-currency inflows, the government announced plans earlier this month that would make it possible for the first time—though still subject to quotas—for firms and ordinary Chinese to invest in foreign securities markets. And it is widely predicted that the central bank will soon announce measures to curb credit growth by increasing the ratio of bank deposits that must be kept with it in reserve.

Still, with big events approaching—a five-yearly Communist Party Congress late next year and the Beijing Olympic Games in 2008—China's leaders are anxious that the economy keep growing fast enough to ensure stability. This may make them reluctant to take the really tough measures necessary to ensure more rational growth: lifting controls on energy prices, for example, and removing restrictions on bank interest rates. Chang Qing, of China Agricultural University, says he believes that central-government efforts are unlikely to have much impact, and that China will find it difficult to avoid a hard landing in a couple of years' time. Government officials, however, still insist that the economy is not overheating—yet.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Nepal

Knights and pawns check king

Apr 27th 2006 | KATHMANDU
From The Economist print edition

People power wins in Nepal—for the moment.

IT WAS Nepal's army that finally called time on King Gyanendra's disastrous attempt at absolutism. Faced with the prospect of either mowing down unarmed demonstrators or seeing the palace stormed, the generals went to the opposition and asked them to form a government on the eve of a huge rally planned for April 25th that would have been in violation of a near-total curfew.

Reuters

Victory parade

Although foreign diplomats and others were involved, it was almost certainly the army that brought the news to Nepal's deluded sovereign that the game was up. Shortly before midnight on April 24th, a shattered-looking king appeared on national television, to read words written by his democratic enemies. He restored the parliament that had been dissolved four years ago, implicitly accepted the opposition's policy of securing peace with the Maoist rebels by rewriting the constitution, and offered his condolences to the families of the 15 protesters shot dead on his orders during 19 days of mass demonstrations against his regime.

For the first time in many years, the outlook for Nepal seems hopeful. The alliance of seven political parties, which now forms the government, reached an agreement with the powerful Maoists last year with the aim of restoring peace and adopting a new constitution. Girija Prasad Koirala, now 84 years old, has become prime minister for the fifth time, and says the preparation of a constituent assembly will be his first act when parliament convenes on April 28th. A Maoist ceasefire was announced on April 27th, for three months to begin with.

The movement got its momentum from the Nepali people's fervent wish for peace with the Maoists after a decade-long civil war that has cost some 13,000 lives. It was intensified by King Gyanendra's obstructive attitude towards the achievement of that peace. Since the political parties offer a solution, they are apparently being forgiven their past sins. But the public is sure to remain

wary of their new leaders.

Previous democratic governments, including those led by Mr Koirala, have been inept, corrupt and short-lived. It was the politicians who dissolved their own parliament in the first place, opening the way for the king to seize power. As the crowds celebrated their victory this week, their message was clear: don't betray us again.

The road ahead is difficult. Nothing has been decided about how the constituent assembly will work—and it is not even absolutely clear that Mr Koirala will be able to convene one. Negotiations with the rebels will be awkward and drawn out. Although they acknowledge that they cannot win militarily, they have shown themselves to be shrewd, and this week hardened their position publicly before getting down to business.

International expertise in the highly technical process of supervising a ceasefire, holding peace talks and organising elections will be needed, though it is sure to be available if sought. Trials, or a reconciliation effort, for crimes committed on both sides of the conflict will play a role. Western aid money, reduced after the king's coup last year, should now flood back in, though Nepalis will hope that donors perform better than in the past, when billions were spent to little effect.

The democratic government will also want to bring the army under control and dismantle whatever remains, once the dust settles, of the palace's power. Under the existing constitution, the army is answerable only to the king. But Pyar Jung Thapa, the chief of staff, is sounding co-operative, pledging loyalty to the new government and speaking of absorbing rebels into the army under a peace deal.

And what of the king? His fate may be decided by the people if and when they vote on a new constitution. This week many of his most despised lieutenants were believed to have already fled; the country had no functioning government for three days. Republican sentiment is running high, although the two largest parties, and some foreign governments, would like to see a purely ceremonial monarchy remain. But the Shah dynasty has nothing to offer and King Gyanendra, a man of blood, may have to go.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Sri Lanka

The gates of war open

Apr 27th 2006
From The Economist print edition

A suicide bomb strains the faltering ceasefire

Get article background

ON APRIL 25th a Tamil Tiger suicide-bomber blew herself up at the army's heavily-fortified headquarters in Sri Lanka's capital, Colombo, seriously wounding the country's hawkish army chief, Sarath Fonseka, and killing a number of his bodyguards. The audacious attack, carried out by a bomber disguised as a pregnant woman, was the latest in a string of tit-for-tat murders over the past few months that have placed growing strain on the ceasefire agreement signed by the government and rebels in 2002. Only heroic efforts will prevent a return to full-scale conflict.

Much of the violence has been taking place in the island's multi-ethnic east, a region that is claimed by both sides. Tensions there have risen in recent weeks, following a spate of rebel landmine strikes on Sri Lankan soldiers, and revenge attacks by Sinhalese mobs on Tamil villagers that have left more than 100 people dead.

Talks in February, aimed at shoring up the truce and thus paving the way for stalled peace talks to resume, ended with an agreement by both sides to rein in the violence. But as soon as the ink had dried, the government accused the Tigers of attacking its soldiers, while the rebels claimed the army was continuing to encourage paramilitaries, led by a renegade Tiger commander, to attack its forces in the east. Follow-up ceasefire talks this month have been held up, amid bickering over the manner in which eastern rebels should be allowed to travel to a pre-talks meeting with the Tiger leadership in the north.

The truce began unravelling after the election in November of a hardline Sinhalese president, Mahinda Rajapakse, whose party's main coalition partners, the JVP and JHU, have repeatedly called for the existing ceasefire agreement to be scrapped or redrafted, and for an end to Norway's role as peace-broker. Since then, the two sides have accused each other of carrying out a shadow war.

This latest attack, at the heart of Sri Lanka's military establishment, may well have been the final straw for the government, whose retaliation was swift. By the evening of April 25th, air-force planes, supported by naval artillery, were pulverising rebel positions near the north-eastern port of Trincomalee, sending thousands of local people fleeing into the jungle for refuge.

The Tigers have threatened retaliation if the onslaught continues, suspecting the government of preparing a full-scale offensive to win control of the east. Some in the government hope this would enable them to negotiate from a position of strength in any future talks. Losing the east would be a huge setback for the rebels, who regard the region as part of Tamils' homeland.

India

Caste and cash

Apr 27th 2006 | DELHI
From The Economist print edition

Business fears quota legislation

Get article background

INDIA's business leaders have recently been enjoying the benefits of becoming internationally competitive, after decades of leaden regulation. Now, they have taken fright. The reason is an inferred warning that the government is thinking of setting quotas for the number of people from the poorly-educated bottom end of the Hindu caste system they should employ. What seemed to make matters worse was that it was none other than Manmohan Singh, the prime minister, who gave the warning, when he said, on April 18th at the annual conference of the Confederation of Industry, that it would be best for them to take action voluntarily.

“We've no alternative but to hire the best talent available, within India and globally,” retorts Azim Premji, head of Wipro, one of India's leading software companies, echoing a general mood of mild panic. The compulsory hiring of sub-standard workers, he and others fear, could hit profitability and international confidence, pricking India's current bubble of economic success.

Mr Singh had been characteristically mild. All he did was urge companies to assess “the diversity in your employee profile”, and commit themselves, voluntarily, to broadening their workforce and to taking a more active social role. But his audience seems to have taken it as a genuine threat that, if they do not respond, action, in the shape of legislation, may follow.

“Scheduled” castes and tribes—the lowest groups in India's caste system—have had claim to just over 20% of government and other public-sector jobs since 1950. This system was extended in 1990 to include another 27% for marginally better-off “other backward castes”. Leaders from all these lower castes now fear that these benefits will be eroded as privatisation reduces the size of the public sector (though not many state assets have yet been sold or are likely to be sold soon). The Congress-led government's policy programme, which it adopted in May 2004, said it was very sensitive to the issue of job-preferment, as well as the reservation of some jobs for certain groups, in the private sector, where low-caste employees are well represented only in the most menial jobs.

A ministerial committee has now passed the buck back to the cabinet, which is expected to consider possible draft legislation in May. The committee said that an amendment to the constitution might be needed, as well as new laws. In a separate initiative, the human-resources ministry has horrified industry, academia and students by proposing a reservation of 27% of places in universities and management and technical institutions for “backward castes”, on top of the 22.5% already reserved for scheduled castes and tribes.

Stung both by Mr Singh's speech and perhaps by the realisation that companies have not done much in the past, business organisations are now preparing plans for voluntary action. These will

probably include improving education and training opportunities, and providing introductory coaching classes for higher education. The government is also considering introducing tax breaks and other incentives for low-caste employment in poor areas. All that should help the anti-legislation lobby. But caste divisions play a potent role in Indian politics. The threat of quota laws will not easily be dismissed.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Vietnam

Manh alive

Apr 27th 2006 | BANGKOK
From The Economist print edition

But other heads will roll in a graft scandal

TWENTY years ago Vietnam's ruling Communist Party introduced *doi moi*, a "renewal" slogan that meant, as in China, moving towards a free-market economy while maintaining the party's absolute monopoly on political power. The plan has worked fairly well since then: poverty has fallen sharply as the country has enjoyed impressive growth, and social stability has largely been preserved. However, at the party's five-yearly congress, from April 18th to 25th, there was unprecedented frankness about a big threat to its continued legitimacy: corruption, which a senior delegate said was becoming more common and more organised, and spreading across all areas of government.

Vietnam's normally tightly-controlled press has been given free rein to report on recent cases of high-level graft, especially at Project Management Unit 18, a road-building agency, where officials embezzled millions of dollars of foreign aid to bet on football matches. Earlier this month, the transport minister resigned and several officials were arrested. But the big question this week was whether the country's most senior leader, Nong Duc Manh, the party's general secretary, would also be forced out, after it emerged that his son-in-law was a boss at the agency (neither man has been personally implicated).

Mr Manh survived, winning a second five-year term, though in the finest bureaucratic tradition assistants' heads will roll to placate public opinion. The country's next most senior figures—President Tran Duc Luong and the prime minister, Phan Van Khai—are expected to be replaced shortly, having just lost their Politburo seats. Mr Manh pledged to be tougher on corruption in his second term, and to press on with Vietnam's economic reforms. These will soon be given a big shove when it joins the World Trade Organisation, perhaps this year or next.

Vietnam's WTO bid has suffered delays, but the country is now close to completing the bilateral deals it must strike with America and other trading partners to win their backing for its entry. Earlier this month, Dennis Hastert, the speaker of America's House of Representatives, visited Hanoi and said he would urge approval of Vietnam's WTO entry, despite continuing concerns over human rights.

The WTO's bans on subsidies and monopolies, and the other pledges that Vietnam has made to win other countries' support for its entry, will make it harder for ministers to continue propping up state firms by leaning on the banks to lend them money. To encourage investment, the government recently eased restrictions on the foreign ownership of firms. It promises a further big

liberalisation, especially of the banking system. But it still talks about combining such reforms with a continuing “socialist orientation”, reflecting how the older generation of war veterans in the party's senior ranks has not yet been displaced by younger, more liberal and often foreign-educated members from below.

The party congress approved a law letting its members engage in business, as its Chinese equivalent did several years ago. In truth, many party bosses are already up to their necks in capitalism. Besides running private businesses on the side, party hacks manage the country's state firms, enjoying as much autonomy as if they actually owned them. Some were given their jobs as a reward for being “war heroes”. Few were chosen for having any management qualifications. In itself, the new law will do little to make state firms better run or foster the growth of private industry, though it may help expose conflicts between state officials' duties and their private interests.

Though its official target is to become a middle-income country by 2020, Vietnam dreams of doing better than this. It feels that, but for the decades of war it suffered until the 1970s, it would be up there with the richest Asian tigers, like South Korea and Singapore, and way ahead of its most obvious peer, China. For such dreams to start coming true, Mr Manh will have to mean what he says about pushing on with liberalisation and hammering corruption. And socialism? Forget it.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The Solomon Islands

The in and out prime minister

Apr 27th 2006 | HONIARA
From The Economist print edition

Good news, of a sort

JUST eight days into his term in office, the Solomon Islands' new prime minister, Snyder Rini, was forced to resign on April 26th, after five members of his coalition had crossed the floor. His downfall was greeted with jubilation on the streets of the capital, Honiara. It will also have come as a relief to James Batley, the Special Co-ordinator of the Australian-led Regional Assistance Mission to the Solomon Islands (RAMSI).

The election the previous week had been a disaster. It triggered riots on the streets of Honiara, during which the Chinatown district, the Pacific Casino Hotel and many other Asian shops were burnt down. The disturbances then spread to neighbouring Malaita island and the Russell Islands. Twenty-eight Australian police officers were injured. Had Mr Rini's government continued in office, RAMSI might have found itself in the awkward position of propping up a deeply unpopular government in the face of mounting protest.

Normally, the elections, held on April 5th, would have spelt defeat for the previous government, in which Mr Rini was deputy prime minister. Eight of the 20 ministers lost their seats, and only three members of the People's Alliance Party, led by the prime minister, Sir Allan Kemakeza, were returned. But Solomon Islands elections have notoriously unpredictable outcomes. Once the winners were declared, new and old MPs arrived in Honiara from the provinces to begin a policy-free discussion with lobbyists, many of them logging companies and casino operators bearing bribes. A Taiwanese warship docked in the harbour and invited the newly elected MPs aboard, contributing to what Alexander Downer, the Australian foreign minister, called the “inappropriate incentives” involved in selecting a prime minister.

Mr Rini's resignation now opens the way for the opposition to attempt to form a government next week. Two of its members are currently in prison, accused of inciting the crowds to riot outside parliament last week. The rest are a motley crowd with little common ground in terms of policy. The urgent tasks will be to forge a new partnership with RAMSI and to rebuild an economy that has been seriously damaged by the displacement of around 600 Chinese, the backbone of commerce and business in Honiara.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Egypt's bombs

Punishing the West, all things secular and Egyptians too

Apr 27th 2006 | CAIRO
From The Economist print edition

Reuters

A series of suicide-bombings in Sinai suggests a dangerous radicalisation of Egypt's homegrown Islamist groups

Get article background

DIVERS at the palm-fringed bay of Dahab were not combing its reefs for corals this week. They were searching for body parts, after the triple suicide-bombing on April 24th that wrecked the promenade of this quiet Sinai resort, killing 24 people, most of them Egyptians, and wounding 100. Two days later, two bombers struck near a base at Goura that is used by international peacekeepers, killing themselves but causing no injuries.

It was the third time terrorists had hit the rugged peninsula's beaches, and the second that they had attacked its peacekeepers, who monitor Egypt's border with Israel under peace accords signed in 1979. The casualty toll from the beach bombing was lower than in the similar bombings last July in Sharm el-Sheikh to the south, which killed 67 people, and in October 2004 in Taba to the north, which killed 34. But the audacity of this week's bombings may cast a deeper chill.

Egyptian police had reacted vigorously to the earlier attacks, arresting hundreds and killing half a dozen armed suspects, including the alleged ringleader of a militant Islamist group, based in the impoverished north of Sinai, that was believed to have carried them out. Stringent security was enforced across the peninsula, an increasingly fashionable tourist destination, and also a favoured resort of Egypt's president, Hosni Mubarak.

The easy penetration of that security by this week's attackers, and their undiminished determination to create mayhem, came as a shock to Egypt's authorities. Dahab was unusually packed with visitors for a long weekend combining three Egyptian holidays: an ancient spring festival; the Easter celebrated by Egypt's big Coptic minority; and Sinai Day, marking the peninsula's liberation from Israeli occupation.

The earlier beach attacks in Sinai also coincided with secular Egyptian holidays, a fact that should have alerted the Egyptian police to heightened danger. Only days before the bombings, the Interior Ministry uncovered what it described as a radical cell in Cairo, among whose purported aims was the punishment of “degenerate youth” in tourist areas. Last month, Israeli counter-terrorism officials issued a warning to Israelis not to travel to Sinai, because of the danger posed by “small groups affiliated to al-Qaeda”.

All the attacks adopted the now classic al-Qaeda trademark of multiple, simultaneous suicide bombs. Monday's strike at tourists came a day after al-Qaeda's leader, Osama bin Laden, issued a tape-recorded call for continued *jihad* against “Zionist Crusaders”. Yet no group has claimed responsibility for any of the attacks, and the Egyptian police say that the only evidence they have of outside links is the accessing of jihadist websites by suspects apparently interested in bomb-making techniques. Security officials say the devices used in all the Sinai bombings were home-made. Egypt's minister of the interior, Habib Adly, says the nail-packed explosives used at Dahab were particularly primitive, hinting, perhaps, that the perpetrators' capabilities are diminishing.

Whether the Sinai attacks were the work of bona fide al-Qaeda offshoots or just copycat groups, their timing and choice of targets point to internal, Egyptian motivations. Islamists of the Salafi-Jihadi school—ie, those who believe in struggling for a return to the puritan faith practised in the Prophet's time—anathematise all Western influence, all accommodation with Israel and all that is secular.

The Sinai represents all these things. The sight of Western and Israeli tourists disporting themselves on its beaches so close to the “*jihad* zone” of Palestine, and in so doing “corrupting” Egyptian Muslims, is seen as provocative. The multinational force that patrols Sinai, financed largely by America, is seen as a symbol of capitulation. Choosing to strike on Egyptian holidays suggests a deliberate scoffing at such un-Islamic celebrations.

To the jihadists, Egypt's government, having allied itself with America, made peace with Israel and stood by while Iraq was invaded, is a legitimate target. Yet while popular sympathies side with “resistance” in Iraq and Palestine, and while a great religious revival has roused pan-Islamist xenophobia, most Egyptians accept that their economy relies on engagement with the world. Tourism, which brought a record 8.6m visitors to Egypt last year, generates a fifth of its foreign exchange and employs one in ten workers.

Many of those workers recall the dark days of the mid-1990s, when another bout of Islamist terrorism emptied Egyptian hotels. Extremely rough policing, including the arrest of as many as 20,000 suspects, eventually won that round of violence. But the attacks of the past two years, more indiscriminate than those in the previous round, suggest the formation of new, nihilist groups, radicalised by the harshness of Egypt's police, and inspired by jihadism in Iraq and elsewhere.

The vast bulk of Egypt's broad Islamist movement condemns the violence of the radicals. The Muslim Brotherhood, Egypt's strongest opposition party and also the historical model for groups such as Hamas, called the Dahab attacks a heinous crime and “a flagrant violation of the tolerant and peaceful teachings of Islam”. But it also issued a call for the government to avoid using such incidents as an excuse for political oppression, which it described as the root cause of unrest.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Israel's new government

Farewell to the generals

Apr 27th 2006 | TEL AVIV
From The Economist print edition

What change will be brought about by civilians running Israel?

ONE of the most remarkable things about the new Israeli government that is expected to be sworn in next week is the absence of military men in its front row. For years, the country has been ruled by veterans of its military complex. Now, after the close election a month ago, it is to be led by a team of civilians, whose view of the world has been shaped elsewhere than in barracks or on battlefields.

This week, Ehud Olmert, who became prime minister and leader of Kadima when Ariel Sharon, the party's founder, sank into a coma last January, cut a deal with Amir Peretz, head of the Labour Party. Given the narrowness of Kadima's election victory, Mr Olmert had no choice but to split the booty with Labour. In the new regime, Mr Peretz, a former trade-union boss, will be defence minister, replacing Mr Sharon's appointee, Shaul Mofaz, an ex-military chief of staff.

It's all a big change. Look at Israel's earlier leaders: ex-Generals Yitzhak Rabin, Ehud Barak and Ariel Sharon; ex-guerrilla commanders, Menachem Begin and Yitzhak Shamir; and Shimon Peres, the creator of Israel's defence industry and nuclear programme. Even Binyamin Netanyahu has claims to be a counter-terrorism expert. By contrast, the top people in the new cabinet all lack a security background.

Mr Olmert served as a military reporter, and got his low officer's rank only as a reservist. Mr Peretz ended his short army career as an ordnance captain when he was accidentally wounded. The foreign minister, Tzipi Livni, the daughter of a famed underground fighter, served just four years as a junior intelligence officer in Mossad, Israel's intelligence service. Though there will still be senior ex-security people in the new cabinet, they have been relegated to secondary positions.

The Peretz appointment sent shock waves through the defence establishment, which had got used to having one of its own as minister. The moustachioed Mr Peretz, who campaigned on a social-economic platform, was a natural target for cartoonists joking about his coming moment of initiation into the state's intelligence and nuclear secrets. Indeed, Mr Peretz had favoured the treasury, where he could have moulded economic policies as domestic overlord. But Mr Olmert was determined to keep the country's purse in Kadima's hands. Mr Peretz's first test will be the proposed cuts in the defence budget—cuts he himself had supported.

The Olmert-Peretz partnership is one of necessity, not of mutual admiration. Trying to dispel criticism, Mr Olmert's people have been arguing that the defence minister's position is not all that important since the prime minister has the final word in matters of national security. This is only partly true. The defence boss runs the country's largest and richest bureaucracy, and serves as the de facto ruler of the occupied territories. His decisions directly affect the daily lives of Palestinians in the West Bank and Gaza.

The new team faces huge challenges: a Hamas-led Palestinian Authority, an expected wave of suicide attacks and, perhaps above all, the evacuation of Israeli settlements from the larger part of the West Bank. Judging by Mr Olmert's four months as acting prime minister, he prefers to win international support for Israel's actions, rather than just barging ahead. Unlike Mr Sharon, who remained suspicious of any foreigner, Mr Olmert boasts of his friendships with world leaders. This could signal a refreshing twist in policy.

Critics have long warned Israel against “watching the Arabs only through the rifle's sights”, ie, seeking a military solution to the country's problems. For decades, Israel's rulers have carried their patterns of thought from their military into their civilian careers. The question is whether different personal backgrounds will now be translated into different policies.

It will not be easy. In fraught political circumstances, like those that beset Israel, the quality of leadership can be tested by national catastrophe. A Rabin or Sharon, with their records as heroes, could calm the public after a deadly terrorist attack. Their lack of military credentials could make Messrs Olmert and Peretz less able to lead, and thus even more dependent on the army, under its charismatic and popular chief of staff, Dan Halutz.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Iraq's new prime minister

A man they can deal with

Apr 27th 2006 | BAGHDAD
From The Economist print edition

With the political stalemate broken, there's just a glimpse of hope

AT LAST, months after its parliamentary election on December 15th, Iraq looks as if it may soon have the national unity government that is widely held to be the best chance of preventing the country from splintering into full-scale civil war. Last week's announcement by Ibrahim al-Jaafari that he no longer insisted on remaining prime minister, followed by the ruling Shia coalition's nomination of his comrade in the Islamist Dawa party, Jawad al-Maliki, to replace him, has created a momentum that could result in a government acceptable to Shias, Kurds and Sunnis emerging even before the constitutional deadline runs out a month from now.

The breakthrough has been greeted with praise from world leaders—and with a dramatic new videotape from Abu Musab al-Zarqawi, the Jordanian Islamist who heads al-Qaeda's operations in Iraq. Mr Zarqawi, who was showing his face in public for the first time, called the new Iraqi government an American “stooge” and a “poisoned dagger” at the heart of the Muslim world.

Yet the deep divides remain, particularly between Sunnis and Shias, who are engaged in a series of tit-for-tat militia murders, mixed with the occasional bout of outright ethnic cleansing. Since Mr Maliki and Dr Jaafari (whom the Sunnis and Kurds had declared unacceptable) stand for roughly the same principle—that the Shia majority should exercise its long-denied right to rule a united Iraqi state—it is reasonable to wonder whether the sudden burst of optimism (or in Mr Zarqawi's case, anger) is justified.

Perhaps it is. Iraqi politicians and diplomats point out that the past two months, despite the nasty personalised exchanges between the groups, have not been entirely wasted. Much of the groundwork has been laid for a government of national unity. The Shias have made concessions both to the Kurds (setting a stricter timetable to return refugees to the disputed city of Kirkuk, in preparation for a referendum on its joining an autonomous Kurdistan) and to the Sunnis (agreeing to review the purge of former Baath party members from public life). They have authorised a national-unity council designed to give all the factions the right of oversight over big governmental decisions.

Mr Maliki was the Shia representative at these talks, which is one of the reasons why the other parties think they can work with him better than with Dr Jaafari. Both men are thought to be sincere believers in the Dawa party's brand of Islamism, committed to a state that is guided, though not led, by the collective judgment of the Shia clergy. But while Dr Jaafari is accused of never listening, preferring to mumble clichés rather than debate details, Mr Maliki is thought to be a negotiator who at least makes the effort to understand the other factions' points of view—and who can, if need be, make compromises.

The great white hope is that a national unity government will be the key to ending both the Sunni insurgency and the newly looming problem of Shia militias. It is also hoped that the government

will act against the corruption that drains billions from the country's cash-strapped government, and that it will break through the administrative bottlenecks that block job-creation programmes, leaving unemployed young men with little reason not to become militiamen or insurgent triggermen. The creation of a government will be followed by elections for local councils charged with recruiting policemen and commissioning local infrastructure projects that might persuade rebel-friendly tribes to choose stability over resistance.

All of this may be several hopes too far. The nomination of Mr Maliki was followed quickly by the election of a Kurdish president, Jalal Talabani, and a Sunni speaker of parliament, Mahmoud al-Mashhadani. Each was given two deputies, one from each of the other two main ethnic coalitions, suggesting that a Lebanese-style distribution of posts along sectarian lines will run pretty deep in the composition of the next cabinet. This is not a recipe for clean or efficient government. Also, unless Mr Maliki's ministers can quickly deliver dramatic improvements, Iraqis' natural cynicism, developed over decades of misrule, will swamp any short-term psychological breakthrough.

In the past, the insurgents have timed their offensives to undercut political progress. Mr Zarqawi's threat of new carnage strengthened Iraqis' expectation of some such horror. Even so, the worst-case scenario—political paralysis, followed by the breakdown of state institutions, followed by full-scale civil war—is a little further off than it was a couple of weeks ago.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

African poverty

The magnificent seven

Apr 27th 2006 | SAURI, KENYA
From The Economist print edition

How a few simple reforms can lift African villages out of poverty

WITH its multitude of problems, Africa is often treated like some ailing patient by international agencies, with regular bulletins on the continent's vital signs issuing from its bedside. And in case it ever gets out of the intensive-care ward, it also has a daunting rehabilitation programme to keep up with: the UN's Millennium Development Goals (MDGs), agreed on in 2000,which set such targets as halving the proportion of people living on less than $1 a day by 2015. Other continents have the same targets, but as the most egregious examples of poverty, poor health and under-development are usually to be found in Africa, that is where most of the world's attention is focused.

Beanz means brains

The latest bulletins on Africa's progress bring the usual mix of good and bad news. A combined World Bank-IMF report on the MDGs strikes some hopeful notes. There has been a reduction in child deaths in Burkina Faso and Mozambique, for instance, and the report cites a decline in HIV/AIDS infection rates in such high-prevalence countries as Uganda and Zimbabwe. But the report also says that African countries are still not doing enough to meet their targets on poverty reduction.

A report from Unicef, the United Nations Children's Fund, is still gloomier. Whereas China managed to cut its proportion of underweight children by more than half between 1990 and 2002, in Africa over a quarter of children under five are still underweight, “a catastrophe for development”. Moreover, in east and southern Africa the number of underweight children has actually increased.

It is this sort of statistic that fires up Jeffrey Sachs, a voluble macroeconomist who serves as the

head of the UN's Millennium Project, which aims to see the MDGs achieved. The sometimes pathetic performance of African countries, and in particular their governments, is not, he believes, a fair reflection of the desire and capacity of ordinary Africans to pull themselves out of poverty. Governments, often corrupt, can do only so much anyway. To have a real chance of ending poverty, more needs to be spent at the bottom. In short, Africa's leap forward must begin, barefoot and with hoe in hand, in the parched and pestilential villages where up to 80% of poor Africans actually live.

To this end, Mr Sachs has set up 12 “research villages” in ten African countries (see map), to pioneer models of development that can be replicated by other villages in the future. Another 66 villages have been added to the experiment in clusters around the original 12. The hope is for 1,000 such villages by 2009, with exponential growth thereafter. Each village will receive practical help from the Millennium Project amounting to $250 per person over five years.

Take the experience of three of the villages: Alafia, near Timbuktu in Mali; Koraro, in the Tigrayan highlands of Ethiopia; and Sauri, in the verdant lowlands of western Kenya. The Millennium Project is trying to show how a few simple reforms, seven in all, can substantially improve lives and provide livelihoods. These are: fertiliser and seed to improve food yield; anti-malarial bed nets; improved water sources; diversification from staple into cash crops; a school feeding programme; deworming for all; and the introduction of new technologies, such as energy-saving stoves and mobile phones.

Progress is most advanced in Sauri, the first Millennium village. There, committees of elders (and some not so elderly) have taken responsibility for almost every innovation, proving themselves to be competent and resourceful. According to Glenn Denning, of the Millennium Project's Nairobi office, the incidence of malaria in Sauri has dropped by at least 50% since the distribution of free bed nets. Food yield has more than doubled and villagers say that everyone can now find at least a little to eat. A school feeding programme, whereby farmers give a portion of their harvest to the village schools, has had a dramatic effect. Children stay in school longer and, with a bowl of maize and beans in their belly, are able to concentrate. Since school feeding began, Sauri has risen from 108th to 2nd in district exam results, out of 253 schools.

Almost two years into its five-year boost, there are signs of economic activity in Sauri as well. Several shops have opened. A few people have purchased mobile phones, one or two have managed to invest in dairy cows, and many more are diversifying into cash crops. Most significantly, there are 200 new households in a village of 5,000 people, some of whom have returned from towns and cities.

But is the Millennium-village concept capable of having any real impact across the whole continent? Mr Sachs concedes that the seven reforms can, in the short term at least, be repeated only with “resources from the outside”. This makes the model unduly dependent on foreign aid, a common complaint of Africans about many Western-inspired development projects. Some also claim that the villages suck in resources from neighbouring districts, rather than spreading the benefits outwards.

However, it is still early days, and the ease with which Mr Sachs has raised money from hard-

nosed American businessmen is significant. If you want to help the poor, there is hardly a better investment. Half the children in Sauri carry a range of worms. Some of the worms, such as the hookworm, are disabling. It would cost about the same as a cup of coffee in New York City to deworm a child in Sauri for a year, so the equation goes.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Eritrea

A myth of self-reliance

Apr 27th 2006 | ASMARA
From The Economist print edition

Eritrea's people pay the price for their government's pride

THE secretive ex-guerrilla government has always been good at concealing its real intentions. But Eritrea's policy on aid has become unusually bizarre. One of the poorest countries in the world, with some of its population now facing food shortages, Eritrea is deliberately rejecting help.

This week, the United Nations special humanitarian envoy for the Horn of Africa, Kjell Magne Bondevik, made his first visit to Eritrea, where the UN faces a tricky dilemma. Eritreans are tired and hungry, but the government sticks to a mantra of self-reliance.

In early 2005, the UN estimated that two-thirds of Eritrea's 3.6m people needed food aid, making Eritrea one of the most food-aid-dependent countries in the world. No independent survey has been allowed since then, but aid-workers say that this year's better harvest is still not nearly enough to feed the country. Nobody is starving just yet, they say, but the signs of widespread hunger are showing.

Rather than engaging with foreign governments and international agencies, however, Eritrea expelled the United States Agency for International Development last year, slashed the numbers receiving food aid from 1.3m to 72,000, and has now told at least 11 other international aid organisations to stop their work. Meanwhile, food aid is rotting in the warehouses and further imports have slowed to a trickle.

The government insists that it is best qualified to look after the interests of its own people, and accuses the UN of trying to distract attention from its own failures. Six years ago, at the end of a brutal border war, Ethiopia and Eritrea agreed to respect an international ruling, supported by the UN, that would fix their common frontier. To Eritrea's fury, Ethiopia refuses to accept the ruling without further talks. Eritrea cannot hope to win another fight against its much bigger neighbour. So it has turned its wrath on the UN and the West instead, accusing them of failing to press Ethiopia into compliance. This week, Eritrea's government refused Mr Bondevik's request to release the food aid that is stacked in its warehouses.

Last year Eritrea grounded UN helicopters in the demarcation zone abutting Ethiopia, and expelled several peacekeepers. The heightened tensions brought international interest, but little real progress has been made towards resolving the issue.

At best, analysts question the government's competence. At worst, they now question its intentions, especially towards its own people. Last month an Eritrean presidential spokesman was quoted as suggesting, bizarrely, that the latest order to three large international agencies to stop their work could somehow improve efficiency and maximise the impact of aid. But the affected agencies—the American Mercy Corps, the Irish charity Concern, and Acord, a British group—have done some of the best work in Eritrea, providing support for tens of thousands of vulnerable

people in some of the country's most inaccessible areas.

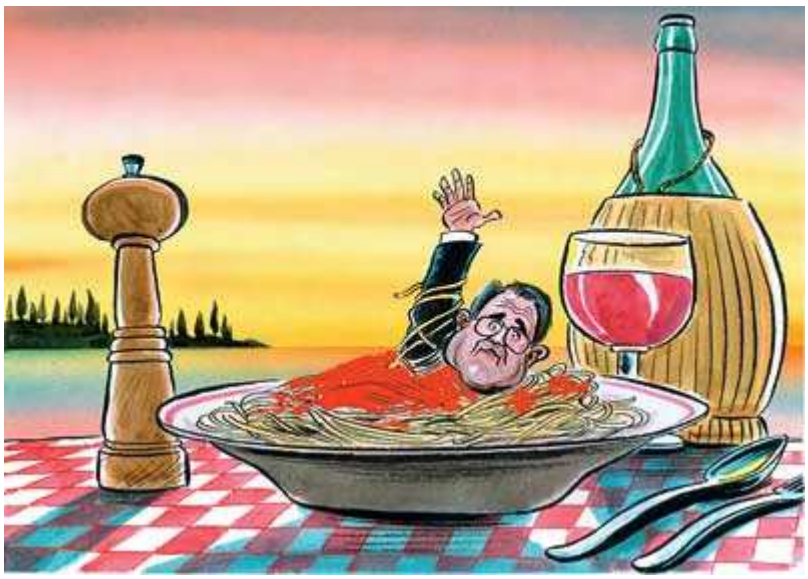
Government restrictions on travel in the country mean that aid-workers are often the only foreigners to reach the remoter regions. So expelling the three charities may be one way of muzzling reports of any impending humanitarian disaster. If Africa's youngest country cannot achieve self-reliance in practice, it can at least seek to create the illusion of it.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Italy's politics

A dog's dinner for Romano Prodi

Apr 27th 2006 | ROME
From The Economist print edition



Gloomy conclusions from arguments over the choices for speaker of each of the two houses of parliament

THE first big test of Romano Prodi's ability to govern Italy might be risible were it not so sad. This weekend, a newly elected Senate is setting about choosing Italy's second-ranking official. The speaker of the upper house is also the country's vice-president: he steps in if the head of state cannot perform his duties. The speaker has “hard power”, filtering legislation through a chamber that, unusually, has the same clout as the lower house. But he also wields “soft power”, as a respected establishment figure with a right to pronounce on the issues of the day.

This time round, the choice of Senate speaker is doubly important. Since the election on April 9th and 10th, it has become clear that the upper house is where the problems facing Mr Prodi and his would-be centre-left government will be most acute. In the election, Silvio Berlusconi's centre-right government actually won more votes for the Senate, but the new electoral rules that, ironically, Mr Berlusconi devised to hurt the centre-left yielded Mr Prodi a wafer-thin majority.

If the centre-left proves unable to get its choice as speaker, it will surely also be unable to govern effectively. Indeed, a failure may reopen the question of its forming a new government at all, and perhaps signal a fresh election instead. The centre-left's inoffensive candidate is a former Christian Democrat trade unionist, Franco Marini. But he faces a formidable challenge from the centre-right's candidate: Giulio Andreotti, an 87-year-old life senator who was prime minister seven times between 1972 and 1992.

The re-emergence of Mr Andreotti beggars belief. Even leaving aside his age, it is hard to think of anybody who better embodies the sleazy, conspiratorial power-broking that characterised Italian politics until the early 1990s. Two years ago, Italy's highest appeals court upheld a lower-court verdict that, until 1980, Mr Andreotti was in “concrete collaboration” with Sicily's Mafia. He escaped criminal conviction only because too much time had elapsed since the offence.

Yet in another sense it is appropriate that this wizened, hunched figure should again be central to Italian public life. For Mr Berlusconi's calamitous decision to reintroduce proportional representation may now revive the political horse-trading from which Italians hoped they had escaped in the early 1990s—of which Mr Andreotti was an absolute master.

The arithmetic is that Mr Prodi's coalition won 158 of the 315 elected seats in the Senate; Mr Berlusconi's side took 156. The last elected seat went to an independent, giving the centre-left a notional majority of one. But there are also seven life senators, most of whom, unlike Mr Andreotti, lean to the left. And Italy's parliamentary politics are fluid. Elected representatives do not always stay with the coalition for which they ran and, even when they do, they do not always vote for it. Already, one senator on Mr Prodi's ticket has said that he will vote for the next speaker “according to conscience”.

In a foretaste of what awaits him, Mr Prodi this week devoted precious hours to securing the support of the Südtiroler Volkspartei, which represents German-speakers in northern Italy. He also spent time wooing the independent senator, an 80-year-old from Argentina who has not lived in Italy since 1952. He is one of six senators chosen by Italian expatriates.

The thinking behind the centre-right's decision to back Mr Andreotti was that some former Christian Democrats belonging to the centre-left might vote for their erstwhile leader out of respect. Mr Andreotti, who has presented himself as the man to reconcile a divided nation, is not the discredited figure in Italy that he is abroad. Quite the reverse. When the ruling on his appeal was announced in 2004, Italy's media and politicians focused on the decision to acquit him on charges of association with the Mafia after 1980.

The outcome of the race for Senate speaker will help to answer one of the two big questions raised by the election: how long a government formed by Mr Prodi might survive. It is the likely choice of speaker for the lower house, the Chamber of Deputies, that hints at the answer to the other question: whether Mr Prodi will be able to force through the radical economic reforms Italy needs.

In the 630-seat chamber, the centre-left enjoys a healthy majority of at least 66—thanks, once again, to Mr Berlusconi's new electoral system, which gives a bonus to the winning side. But Mr Prodi's coalition depends on the support of two communist parties whose leaders can be expected to balk at almost any reforms proposed by a new finance minister, especially hints at more labour-market reform or further privatisations. Both these parties made big gains at the election, giving them powerful leverage over a centre-left government.

The stronger of the two is the Refounded Communists, a party set up as an alternative for those who did not want to join their former comrades in ditching Marxism after the fall of the Berlin Wall. The party now has 41 seats in the lower house and 27 in the Senate. Events since polling day have left no doubt that its leader, Fausto Bertinotti, intends to make this tally count to the full.

It was expected at first that the speakership of the Chamber of Deputies would go to the Democrats of the Left, the biggest party in Mr Prodi's alliance, created by those who did decide to give up Marxism in the early 1990s. Massimo D'Alema, an experienced parliamentarian who was prime minister from 1998 to 2000, was the obvious choice. But Mr Bertinotti decided that he wanted the job and, in the first serious clash within the centre-left since the election, Mr D'Alema,

encouraged by Mr Prodi, withdrew his candidacy.

This episode illustrates not only the power of Mr Bertinotti, but also the pernicious effects of full proportional representation. It has weakened the big parties that underpin coalition governments, and strengthened smaller ones that are only too ready to bring governments down. Once more, this is disturbingly reminiscent of the world before 1994, when parties with even less popular support than the Refounded Communists exerted huge influence by constant threats of defection.

In short, at a time when it ought to be marching bravely into the future, Italy seems to be slipping inexorably back into the past. And that is an even more serious concern than Mr Berlusconi's continuing refusal to accept his election defeat.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

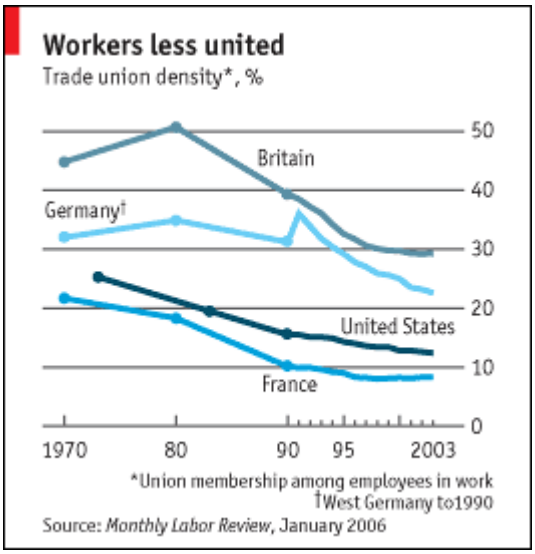
French trade unions

Power without responsibility

Apr 27th 2006 | PARIS
From The Economist print edition

The trade unions have won a victory, but their strength is still declining

Get article background



"IN REALITY, the problem in our country is not that we have too powerful unions, but that they are too fragmented and too small." After the capitulation by the French government to student and union-led protests against its labour reforms, such a statement might seem surprising. It was made recently by Nicolas Sarkozy, the interior minister and head of the ruling centre-right UMP party—and he has a point. Despite their show of strength, France's trade unions are a declining force.

This is not how it feels. This week, Bernard Thibault coasted to an unopposed re-election as head of the Confédération Générale du Travail (CGT), the country's biggest union, at its congress in Lille. He basked in the glory of the protests, which drew up to 3m people on to the streets and forced Dominique de Villepin, the prime minister, to abandon his new flexible job contract for the young. Mr Thibault had been under pressure within the communist-backed union. It had failed in previous confrontations with the government, and Mr Thibault had lost the battle to stop it coming out against the European Union constitution. Now, flush with victory on the streets, he will enjoy renewed authority, and a third term, at the age of only 47.

To loud applause, Mr Thibault congratulated his members on a "beautiful page written by French trade unionism". He stressed the importance of unity: the five main unions had stood shoulder-to-shoulder against Mr de Villepin, avoiding splits that have weakened them in the past. And he called for a new campaign, this time against another job contract, the *contrat nouvelle embauche*, introduced last year by Mr de Villepin. A day of action is promised on May 1st.

Behind this muscular display, however, is a more nuanced reality. After 50 years of decline, just over 8% of workers in France belong to a trade union, compared with 12% in America, and nearly 30% in Britain (see chart). With some 700,000 members, the CGT is less than a third as big as IG Metall in Germany. It has lost two-thirds of its membership since the 1970s. Union clout is now concentrated in the public sector: one in four energy workers is a union member, but in the private sector union penetration is as low as 5%.

So how do French unions manage to keep so much power? One answer is public sympathy. Figures such as Mr Thibault have a revolutionary-chic cult status. Polls show strong support for the recent protests. Families with pushchairs turned out to show solidarity. Such support may explain French people's unusual patience over disruption caused by protests.

But the unions' influence also owes much to an entrenched statutory role. France's unemployment benefit is not run by the state but by an independent body, UNEDIC, which since 1958 has fixed the rate and duration of benefits in direct negotiation with the unions. Under a 1945 law, all companies with over 50 employees must have a *comité d'entreprise* (works council), which they have to consult on many big decisions, not only over working conditions. The companies have to finance these councils and pay their staff, and give them a budget of roughly 2% of overall pay for “cultural and social activities”. At EDF, the state-controlled electricity giant, this is worth an annual €400m ($500m). France's five unions also have a first-round monopoly over who may stand for election to works councils.

Unions thus have a lot of power, but without being representative. Some suggest that this mis-match causes conflictual labour relations. In effect, the unions are defending the interests not of the many, but of the few. Mr Sarkozy has made such an argument to support the idea of breaking the union monopoly on the first round of works-council elections, to encourage wider representation, but also to give a tax break for union dues to boost membership. “Let's help the union organisations to enlarge their base,” he said, “and to become more responsible and more constructive.” A better idea might be to rewrite the labour laws. But, after recent events, nothing looks less likely.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Hungary's election

The re-election precedent

Apr 27th 2006 | BUDAPEST
From The Economist print edition

A sign that politics in central Europe may be maturing

THE first rule of post-communist politics in central and eastern Europe has long been that, whatever a government does, it will be voted out of office. All the reforming administrations of the early 1990s met this fate. So did the softly-softly governments that replaced them.

Such constant changes of government have made outsiders fearful over the fragility of these new democracies. Few prime ministers or parties have completed a full term. Nowhere in the region has a prime minister yet served two full consecutive terms at the head of the same coalition. Parties have been launched, merged and folded with bewildering speed. And, in some countries, populists of extreme right and left are troublingly successful.

AP

Gyurcsany, smilingly re-elected

This week's news from Hungary may herald a change, towards governments that can sometimes win again. After the second round of the election, on April 23rd, the ruling centre-left coalition led by Ferenc Gyurcsany took 210 of the 386 seats in the lower house of parliament, against only 164 for the conservative opposition led by Fidesz. Fidesz's outspoken leader, Viktor Orban, who was prime minister between 1998 and 2002, proved divisive and unconvincing. Even his announcement after the first round that he would not seek to be prime minister again failed to win voters back. At least, unlike some earlier elections, this one was free of anti-Semitism, coded or otherwise.

Mr Gyurcsany's victory was largely personal. A youthful, smooth-talking tycoon with links to the communist-era elite, he is now a keen Blairite, Atlanticist and market-friendly, quite unlike the older ex-communists who still dominate his Socialist Party. He handled Hungary's smaller parties cleverly, keeping his liberal allies, the Free Democrats, happy and also wooing a moderate right-wing party, Hungarian Democratic Forum. This party then doomed Fidesz by refusing to co-operate with it in run-off votes.

The Socialists' slick campaign contrasted with Fidesz's gaffe-strewn effort. Mr Orban gained a few votes on the far right (the main extremist party saw its vote fall by half, to 2%). But he did not appeal to the centre. Having dominated Hungary's right-wing politics for more than a decade, he is now talking of quitting. A big shake-up of the political right looms.

Mr Gyurcsany faces a more immediate test: how to fill the gaping holes in Hungary's public finances, many of which his own government created in a pre-election binge. This year's budget deficit is approaching 8% of GDP; including such off-balance-sheet items as road-building, it would

be nearer 10%. The current-account deficit is over 8% of GDP, one of the biggest in Europe. Foreign investors are edgy.

The government promises “reform without austerity”. It intends to bring in insurance-based health-care and to cut the number of ministries and municipalities. “Our objective is to transform the work of the state so that it is not a burden, but instead serves us,” Mr Gyurcsany has said. Yet, as Juliet Sampson of HSBC, a British-based bank, puts it, “given the Socialists' record on reform, we'll believe real fiscal adjustment is on the way when we see it.”

Elsewhere in the region, re-election may start to become a habit, not a fluke. Many in Poland's minority ruling party, the right-wing Law and Justice, want an early election, hoping to win it. The Czech prime minister, Jiri Paroubek, stands a chance of staying in power after the election in June (though perhaps with his Social Democrats in a different coalition).

It would help if only honest, reformist governments were re-elected, and not spendthrift, soft-talking, sleazy ones. Yet Slovakia's Mikulas Dzurinda is the only prime minister who fits the happier description so far, when he won again in 2002. And he now faces defeat in this summer's election.

Mr Dzurinda's mentor, Mart Laar, who was prime minister of Estonia in 1992-94, believes it is futile to worry about re-election. “Just do the right thing,” he argues, and the voters will eventually appreciate it. That brought him back to power in 1999, though for only a partial term. Now a backbencher who spends much time abroad preaching the virtues of the flat tax and economic reform, Mr Laar laughs off any talk of a comeback. His fans hope that he may be dissembling.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Russian energy

Customer relations, Gazprom-style

Apr 27th 2006
From The Economist print edition

What's ours is ours, and what's yours is ours

THREATENING customers who speak out of turn smacks more of a protection racket than civilised commerce. Yet Gazprom, Russia's state-controlled gas giant, seemed to do just that last week. Alexei Miller, Gazprom's chief executive, apparently linked a putative thwarting of his company's European expansion with a hint that exports could be redirected, say, to China. Misunderstanding? Hardly: this bullying tone seems to be official policy. Indeed, Vladimir Putin, Russia's president, repeated the threat on April 26th, when he spoke of “unfair competition in world markets”.

At the Russian economic forum in London this week, Alexander Medvedev, one of Mr Miller's deputies, snubbed Alan Johnson, Britain's trade and industry minister. Mr Johnson had suggested that Russia should ratify the Energy Charter Treaty (meant to ensure open and competitive energy markets). Peeved by European talk of alternative energy sources, Mr Medvedev declared the treaty “still-born”. Not many Russian bigwigs appeared in London: Igor Shuvalov, a presidential aide who did, said his colleagues think such pow-wows should be held in Russia (rumour had it they also feared meeting Mikhail Kasyanov, a presidential aspirant who wasn't there either). While denying that Gazprom had made threats, Mr Shuvalov affirmed the principle of “reciprocity”.

What “reciprocity” means is that Gazprom wants to buy more “downstream” assets in European countries—pipelines, distribution firms and so on—such as Britain's Centrica. The *Financial Times* reported recently that British officials had considered changing the law to block any Gazprom takeover of Centrica. The *FT* later backtracked on its story, but the Russians were already cross. Mr Medvedev admitted in London that Centrica was one among many “potential acquisition targets” (though he stressed no move was imminent). Meanwhile, Condoleezza Rice, America's secretary of state, issued another warning this week against over-reliance on Russian energy. And Transneft, Russia's oil-pipeline monopoly, predicted the construction of its new Asian pipelines would squeeze westward oil supplies.

Gazprom's position is not entirely consistent, to put it mildly. The Russians sometimes argue that, because foreigners can now buy Gazprom shares, their gas market has been liberalised. But whereas Gazprom demands unfettered access to European assets, access for foreign companies to hydrocarbon deposits in Russia is being circumscribed by a new law. And Gazprom has a monopoly on all Russian gas exports.

Gazprom needs European revenues too badly to think about switching off Europe's gas. Yet the Europeans know Gazprom's decisions can be governed by non-commercial motives—only some of them political. Another rumour this week was that RosUkrEnergo, a shady gas-trading intermediary part-owned by Gazprom, is being investigated by America's Justice Department (a Russian newspaper named two Ukrainian businessmen allegedly involved in it). Still, Gazprom and the Kremlin remain convinced they hold all the best cards.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Berlin's finances

Painful relief

Apr 27th 2006 | BERLIN
From The Economist print edition

The lessons for Germany from a capital and its horrendous debt

WHO'S afraid of Thilo Sarrazin? Much of Berlin—and soon, maybe, many in other German states. No other state finance minister has cut closer to the bone than this combative 61-year-old in Berlin. Other ministers are also watching to see if he wins a case for debt relief that he has launched before the Constitutional Court in Karlsruhe. The court heard arguments this week; it will rule by the summer.

Both the case and Berlin's troubled finances can be understood only in the context of Germany's turbulent history. Until the second world war, the city benefited from being the capital first of Prussia and then of the German Reich. Between 1871 and 1939, Berlin became a booming industrial and financial centre, home to such companies as Siemens and Deutsche Bank. The city continued to thrive after the war, but only thanks to billions in subsidies from both east and west. West Berlin was the “showcase for the western world”; East Berlin the “capital of the GDR” (the ugly shorthand for then East Germany).

The results were bloated bureaucracies, oversized infrastructure and political leaders adept at securing money from above, but not at taking tough decisions. Many hoped that the city would soon regain its former business vitality when it was once again made the capital of a unified Germany. When it did not, Berlin's debts skyrocketed. Today, the city owes more than €60 billion ($80 billion), or some 70% of its GDP, nearly three times the average of all other German states.

Welcome to the bankruptcy club, New Yorkers and residents of other cities that have lived through near-death experiences might say: fire staff, cut services, damn the potholes—and wait for growth to return. But in Germany things are not that easy. Although the states jealously guard their autonomy, they are financially intertwined, both with the federal government and with each other. Most of what they spend is fixed by laws they cannot change unilaterally, and they cannot alter many tax rates. Revenues are shared by a federal equalisation scheme, meant to ensure equal living standards nationwide.

Mr Sarrazin's options, when he took charge in 2002, were limited. Beyond obvious cuts, such as chopping the budgets of Berlin's three universities and opera houses, he negotiated a new pay deal for staff, cutting salaries as well as increasing working hours, introduced reviews of social programmes and outsourced the operation of traffic lights. Not counting interest payments of €2.4 billion a year, Mr Sarrazin plans a balanced budget worth nearly €18 billion next year.

Yet he knew he could not cut spending by enough to reduce the city's debt burden. So it was no surprise when he went to the Constitutional Court in 2003 to try to force the federal government to take over half of Berlin's debts. The court is likely to oblige, not least because Berlin would otherwise drown in its debts, and it would become more expensive for German states to raise money if the markets no longer believed that the federal government would bail them out.

The big question, says Helmut Seitz, at Dresden's Technical University, is whether the court will simply tell the federal government to pay up and Berlin to cut spending even more—as it did in 1992 when Bremen and Saarland also asked to be bailed out. Or the court may choose to repeat and toughen the suggestion it made then: that new rules are needed to stop states drowning in debt in future.

If the court does this, it could change the debate over reforming Germany's federal system, and put new pressure on states to merge. The system now puts the states in a fiscal straitjacket, but lets them pile up as much debt as they like. This inconsistency may have been acceptable when the overall financial pie was growing. But now, says Mr Seitz, Germany must make up its mind whether it wants to be like Austria, which sets strict deficit limits for states but then stands behind them; or like America, where states have more autonomy (though most have balanced-budget laws in their constitutions)—but face the consequences alone if things go wrong. What may be lost in either case is the cherished notion of equality of living standards across the country.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Charlemagne

Euro blues

Apr 27th 2006
From The Economist print edition

A solid currency, maybe, but a shame about the economic performance

NEXT month, the European Union's innermost circle may embark on a new expansion, if tiny Slovenia gets the go-ahead to join the euro, in January 2007. At the same time, an even smaller place, Lithuania, is likely to be rebuffed, and told firmly that it is not ready for the single currency.

Elsewhere the euro is making its mark in a rather different way. Were Italy not a member, there would surely have been a run on the lira by now, given the troubles facing Romano Prodi's would-be centre-left coalition. And there actually has been a run on Iceland's currency—to the extent that some Icelanders have wondered whether they might perhaps be allowed to adopt the euro, please, to prevent further speculative attacks, even though Iceland is not a member of the EU.

In short, as it prepares to expand again, the euro seems to be working more or less as its founders intended. It has brought stability (oil prices of $75 a barrel have had little impact, even though Europe depends more on imported oil than does America). Countries are queuing up to join (all EU countries bar Britain and Denmark, which have specially negotiated opt-outs, are supposed to become members one day). And the tests of readiness to enter the euro remain as they were agreed at Maastricht in 1991: low inflation, budgetary austerity and exchange-rate stability (the so-called “convergence criteria”).

The reality is rather different. The euro is working, in that it is stable, has established itself as a currency and provides a monetary anchor. But it is not working as it was meant to. When it was dreamt up, the euro was supposed to bring about faster economic convergence. A single currency was the logical completion of the single market, it was said, and would encourage more

integration. The end of exchange-rate risk would boost investment and bring economic cycles into line. The reduction in transaction costs would make economies more efficient, boosting growth.

Moreover, a single currency would, it was claimed, foster policy convergence. Because countries could no longer devalue, they would be forced to undergo the hard grind of reform. Since reform would push all countries in a similar direction, the euro would produce convergence. True believers went further, arguing that currency union would, ultimately, bring about political union. Indeed, for them, that was the point. But even short of this, a single currency would still pull economies together. As a result, the perils of a one-size-fits-all monetary policy would not be so worrisome: eventually, one size would, indeed, fit all.

Seven years on, there has been convergence of a kind. The euro area's long-term interest rates are broadly the same: they have converged on Germany's. Some countries, such as Ireland and Spain, have played economic catch-up (convergence in income and wealth), though this may have little to do with the euro as such. Arguably, fiscal policy has converged too. That may sound odd when 13 of the 25 EU countries are being hauled over the coals for running “excessive” budget deficits. Yet euro governments have shown greater fiscal restraint than their peers in America or Britain in the past few years.

There has, however, been less convergence of economic performance. Ireland has grown by an average of 6% a year since 1999, Germany by barely 1%. Spain's growth has been twice Portugal's. As a recent paper* from Bruegel, a think-tank in Brussels, points out, such divergences are no greater than among American states, but in America they usually result from states being at different points in the economic cycle; in Europe, growth differentials seem to be more persistent. There are few signs that economic cycles have become more closely aligned.

Even when countries have experienced similar pressures (loss of competitiveness, say), they have reacted differently. Ireland and Italy have both lost competitiveness (by running above-average inflation). But Irish exports have boomed, whereas Italy's have stagnated. Germany and France have both gained competitiveness (having below-average inflation), but French exports have been weak while Germany has regained its position as the world's biggest exporter of goods.

As a result, the risk of the euro's one-size-fits-all policy (that interest rates will be too loose for the hares, too tight for the tortoises) has been unpleasantly realised. And as for the broader ambitions for the euro, European countries have not noticeably converged upon economic reform, still less political union: witness the rejection of the draft EU constitution last year by French and Dutch voters.

In search of reality

The euro, in short, has provided currency stability but has done little to promote growth, jobs or reform. That is a long way from branding the currency a complete failure. But it is clear that what matters most is the “real” side of the economy (growth, jobs, markets), not the nominal indicators of stability (inflation, budget deficits) that are used to decide both whether countries are ready to join, and how they are doing once they are in.

A key lesson is that flexible economies, such as Ireland's and Britain's, thrive, whether in or out of the euro. Inflexible ones can claw back lost competitiveness even inside the euro—but this takes a long time, and can come at a high price because they must keep growth in unit labour costs below average for years. Germany has done this. Italy and Portugal now face the same challenge, but without the German tradition of belt-tightening.

For countries now anxious to join the single currency, however, economic considerations hardly

matter. They wanted to join the EU to show they were normal countries and now want to join the euro to show they are good Europeans. But being a good European can come at a cost—and it is not clear that all of the aspirants either understand this or are ready to pay.

---

* "The euro: only for the agile". By Alan Ahearne and Jean Pisani-Ferry

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Labour and crime

Law and disorder

Apr 27th 2006
From The Economist print edition

Tony Blair may have had worse weeks in politics but it is hard to think when. The first of three articles looks at Labour's confused record on criminal justice

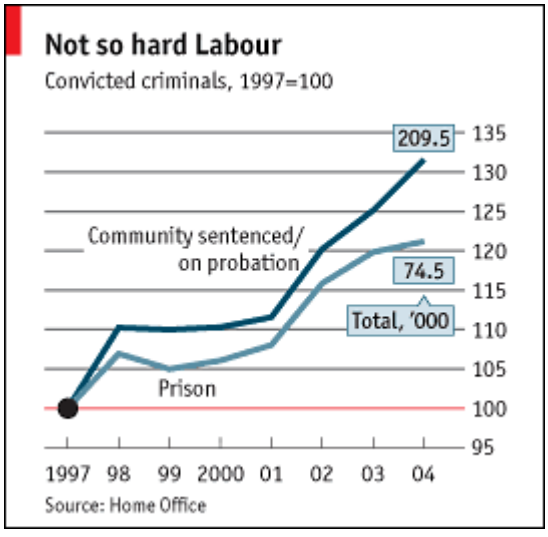
Get article background

EARLIER this week, Tony Blair and Charles Clarke, the home secretary, corrected some misapprehensions about Britain. It is not a police state. Nor is it a gulag, a fascist state or a nation in which the rule of law has been overthrown. Such calumnies, they complained, have been put about by journalists and a retired judge who make Labour out to be more authoritarian than it actually is.

Proof, of an odd and unwelcome kind, was soon forthcoming. On April 25th, Mr Clarke admitted that, since 1999, 1,023 foreign convicts who ought to have been considered for deportation after serving their sentences had simply been released onto Britain's streets. Among them were three murderers and nine rapists. Fully 288 had been released since last summer, when the Home Office became aware of the problem. The tabloid press, which dislikes foreign criminals even more than the home-grown kind, was apoplectic. Britain, a police state? If only.

The problem, as the Home Office lamely explained, is that there are a lot of foreign prisoners to cope with. Their numbers have increased steeply in the past decade, from 4,300 in 1996 to at least 10,300 this spring. The inept, over-stretched prison service failed to let immigration officers know that many convicts were nearing the end of their sentences. Sometimes they did, but the similarly incompetent immigration service failed to act.

The scandal, which may yet cost Mr Clarke his job, illuminates some important features of Labour's record on law and order. Since 1997 the government has pursued a tough criminal-justice agenda. It has added new and draconian laws to the statute book, the kind that outrages judges and liberal newspapers, including this one. As a result, the prison population has risen (see chart). But the bigger, more complex criminal-justice machine that has resulted is unmanageable and, in some respects, worse at protecting the public.



Labour ministers like to say that their criminal-justice policies are attuned to public concerns, and this is true. The government tends to proceed by identifying a menace, be it terrorism, knife crime or teenage rowdyism. Against the protests of civil libertarians, it then creates new powers to deal with this menace. A team of civil servants cajoles the police into using the

new powers. Statistics are collected, and, with luck, the menace is shown to wane. Mr Blair was at it again this week, pledging to let the police seize the cars of suspected drug dealers unless the owners can prove they came by them lawfully.

Since the mid-1990s, criminal-justice bills have appeared at the rate of two a year—roughly double the 1980s rate. That is, in itself, a problem. “The amount of new legislation is so huge that very few full-time judges are fully aware of developments in the law,” says one criminal-court judge. Once senior wigs get around to scrutinising the new laws, they often find things that need to be clarified, or changed.

Creating more crimes has created more criminals. But the prison population has been driven upward mostly by stiffer sentences for old-fashioned crimes. In 1993 49% of those sentenced in the Crown Court and 6% sentenced in magistrates' courts (where less serious offences are dealt with) received custodial sentences. By 2002 the courts were putting away 63% and 16%, respectively. This is not because they were dealing with more heinous crimes. In 2002 magistrates handed custodial sentences to one in four of those who stole from cars—the classic petty offence. In 1993, just one in 20 met that fate.

One reason is more rigid sentencing codes, some of them laid down by the previous Conservative government. The vogue for minimum tariffs for the most serious crimes has produced more life sentences (numbers have more than doubled since the early 1990s). It has also encouraged stiffer sentences all round: judges, like teachers, like to grade on a curve.

Tougher sentences have kept ne'er-do-wells off the streets, but they have not persuaded them to change their ways. More than two-thirds of those released from prison in 2002 re-offended within two years. That was a slightly worse record than for a cohort two years earlier. The readiness with which criminals slip back into crime is striking, considering that there is less of it about. Since it peaked in 1995, overall crime has fallen by 44%, and burglary and car-breaking have tumbled by more than half. Most people are finding it easier to stay straight; convicts are not.

Prisons are now so overcrowded, and the drawbacks of the bang-'em-up approach to criminal justice so obvious, that the government is toying with more (whisper it) liberal methods. Criminals with drug problems are now likely to be sentenced to treatment programmes, which can feature such rigours as motivational training and aromatherapy. Others receive probation, curfews and community work. The numbers serving such sentences have increased more steeply than the prison population in the past few years.

Mike Hough, at King's College London, says community sentences and treatment programmes have not, so far, shown dramatic results. At best, they shave a few percentage points off the odds that a person will re-offend: “People aren't very malleable by the time they have been through the system a few times.” Still, any gains are welcome. So are the government's quiet efforts to make alternatives to prison work. A more urgent task, though, is to keep track of those behind bars.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Labour and sex

Caught in the storm

Apr 27th 2006
From The Economist print edition

Why John Prescott is too valuable to let go

AFP

Protecting the protector

UNDER normal political circumstances, the revelation of a two-year affair between John Prescott, the 67-year-old deputy prime minister, and his much-younger secretary, Tracey Temple, would have provided fun for the tabloid newspapers, embarrassment for Mr Prescott and pain for his family—and not much more. But times are anything but normal. The day on which his affair was made public, April 26th, saw other examples too of ministerial arrogance or incompetence. It all combined to give the strong impression of a government running out of control.

Mr Prescott is a big figure in British politics, and not just physically. Though his self-importance and mangled syntax make him the butt of frequent jokes, his working-class origins and trade-union background have been vital to New Labour. Tony Blair knows that he is seen by some in the party as a carpet-bagging outsider. Making Mr Prescott his deputy in 1994 was a clever political move. As long as John Prescott stood by him, willing to go out and thump tubs (and, on one occasion, a hostile voter) for the New Labour project, Mr Blair had the cover he needed to turn Labour into a post-socialist party.

That Mr Prescott was prepared to play this role says as much about him as it does about Mr Blair. On the left during Labour's wilderness years in the 1980s, he was nonetheless an early advocate of bringing private sources of finance into the public sector. Although some were happy to remain in ideologically virginal opposition, Mr Prescott wanted power and was willing to compromise to get it.

In government, Mr Prescott has continued to give the prime minister loyal service. He often acts as the go-between when Mr Blair's always-tense relationship with the chancellor, Gordon Brown, is going through a bad patch.

But he has not been cheap to run. Nicknamed “Two Jags” because of his liking for large cars and re-christened “Two Shags” since Wednesday, Mr Prescott also insisted on having large departments to run. Having made a mess of transport policy, he was given responsibility for local government, planning and much else in the sprawling Office of the Deputy Prime Minister. One of Mr Prescott's pet schemes, which was humiliatingly rejected by voters in the north-east, is to saddle England with expensive regional assemblies.

Mr Prescott's dignity is a fragile creature and it may have been irreparably damaged by published

pictures of him cavorting with his mistress. But if he has the heart to carry on, and the prime minister shelters him from the storm, he will serve both Mr Blair and Mr Brown well for some time yet.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Labour and the health service

Trimming the fat

Apr 27th 2006
From The Economist print edition

The NHS needs to diet

Get article background

NURSES heckled Patricia Hewitt when she addressed them on April 26th. The reception that the health secretary got earlier in the week at the annual health conference of Unison, a big public-sector union, was also hostile. Ms Hewitt had made a rod for her back with a foolish claim that the deficit-ridden National Health Service had just enjoyed its best year ever. But the unions' disaffection is a sign that the government is doing something right.

The unions are worried about redundancies as NHS trusts struggle to get their finances in order. Over 7,000 job losses have been announced, and the tally seems sure to grow in the months ahead. However, such staff reductions are tiny compared with the boost to NHS employment since Labour took office nine years ago.

Official figures released this week show the scale of the expansion. Between 1997 and 2005, the total NHS payroll in England rose by over 300,000 to 1.37m (see chart). That increase of 29% was almost matched by the increase in hospital and community nurses, whose ranks swelled by over 80,000. The number of other clinical staff grew even faster. There are now 49% more hospital consultants than in 1997.

The increased supply of doctors is welcome because Britain has historically had rather few in relation to its population. The number of administrators working in hospitals to help clinicians and in NHS central support functions has increased at a similar pace, however. And while, given the size of the health service, there are not that many managers—fewer than 40,000 in 2005—their number has risen fastest of all, by 78% since 1997.

The distinction often drawn between “front-line staff”—who are seen as good—and administrators—bad—makes little sense. Consultants work more efficiently if they have medical secretaries and other clerical support. Indeed, the current financial mess in many parts of the NHS shows a lack of effective management.

Even so, the rapid expansion of administrative personnel is a worry. The suspicion is that many of the jobs have been generated simply to help hospital trusts comply with a plethora of targets. The NHS may thus, paradoxically, have become over-administered in the past few years while

remaining under-managed in the functions that really matter.

Another cause for concern is that so many of the extra jobs have been in hospitals. The number of family doctors and GP practice staff, by contrast, has risen rather modestly. Piling people and resources into hospitals has been a strategic mistake. The government is now, belatedly, pushing for a shift in treatment out of expensive hospitals. It also wants GPs to play a big role in commissioning hospital care in order to curb costs.

A recent report from Reform, a think-tank, said that centralised manpower planning had "produced a staffing investment which is unbalanced and unaffordable". It estimated that the NHS payroll could fall by 10% as market pressures begin to bite within the health service. Not before time, the new imperatives to raise efficiency and to meet financial targets are bringing the NHS jobs boom to an end.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

M&S and Debenhams

A tale of two retailers

Apr 27th 2006
From The Economist print edition

How two shopkeepers followed different paths in search of wealth

FORMER investors in Debenhams are kicking themselves. After selling Britain's second-largest department-store chain to private-equity groups in 2003 for £1.7 billion ($2.9 billion), 38% more than the shares were worth before the bid, they have watched others make far bigger profits from it. Texas Pacific, CVC Capital and Merrill Lynch Global Private Equity put up £600m to buy the company. By some estimates they will have quadrupled their money when they float it again next week.

Meanwhile the owners of Marks & Spencer, Britain's biggest clothing retailer, are feeling smug. Its share price has risen by nearly two-thirds since the board brought in a new chief executive, Stuart Rose, almost two years ago to fend off an unwelcome takeover. The company's market value has increased by £2 billion.

Both these companies, which faced similar choices at similar times, have generated spectacular wealth in just a couple of years. But they managed it in very different ways. How they did it, and which strategy will prove the more durable, is greatly exercising the British business mind, already discombobulated by the recent blast of debt-fuelled takeovers.

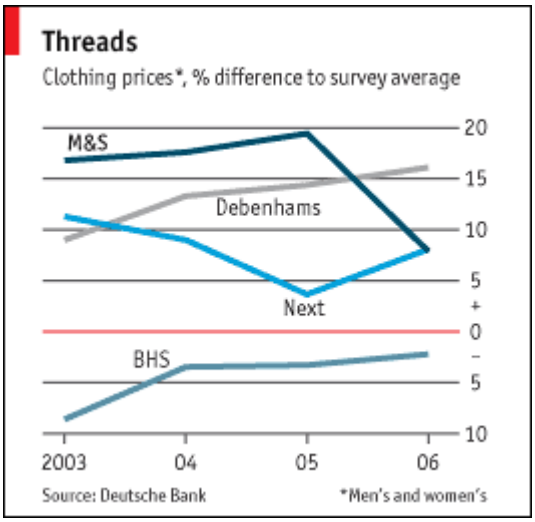
Debenhams, say its fans, is a private-equity pin-up. Its managers have posted a 15% rise in sales, increased the company's share of the department-store market from 15% to almost 19% (according to Verdict, a retail-research company) and widened its operating margins to almost 16% from 12%. But critics argue that the rise in sales and profitability is unsustainable: the financial restructuring of the firm may harm its ability to keep on growing.

First of all, the company will come to market weighed down by £1.2 billion in net debt, about ten times what it was in 2003. The fact that the purchase of Debenhams was financed—as most leveraged buyouts are—by loading its balance sheet with debt need not be a bad thing. Nothing focuses managers' minds on maximising profits like having to meet hefty interest charges, and increased borrowing can also cut a firm's tax bill. But a big debt burden does make the firm riskier to own, sensitive not just to a rise in interest rates but also to a downturn in the retail market.

Debenhams also has fewer physical assets underpinning its increased debt these days. It sold all of its prime properties last year to help finance some of the £1.3 billion in dividends paid out to its new shareholders. Selling property isn't unconventional: Tesco, Britain's largest supermarket, which announced record after-tax profits of £1.6 billion this week, said it plans to free £5 billion by selling and then leasing back some of its stores. But Debenhams' scale is extreme—even Tesco plans to keep 70% of its property. Moreover, Debenhams cut back capital spending—investing less in sprucing up its stores over the past 30 months than John Lewis, a smaller rival, spent in a year. “They have squeezed this business like a lemon,” says Richard Ratner of Seymour Pierce, a stockbroker.

If Debenhams generated most of its returns for shareholders by financial restructuring, Marks & Spencer has, broadly, looked to improve its basic retailing business. True, M&S tinkered with the balance sheet, selling its credit-card business and borrowing to buy back some of its shares. But Mr Rose says that he does not want to sell the company's properties and release capital: he is, he says disarmingly, a “bricks and mortar man”. So the overwhelming increase in its profitability came from cutting costs and winning shoppers.

After decades of graceful growth from selling cotton knickers and cashmere sweaters to middle-aged, middle-income Britain, the firm had found itself at the dawn of a new century with its aisles full of retired folk and its managers overcome by torpor. Less than 3% of the clothes purchased by women in their early 20s came from M&S, compared with more than 20% of those bought by women from their mid-50s, according to Deutsche Bank.



To get younger customers, Mr Rose has brought in new lines and cut prices. A year ago M&S's prices were at least 4% higher than those at Debenhams (see chart); now they are 10% lower, about the same as at Next, a high-street chain, and higher than at BHS, a department-store chain. Its net profit margin, which shrank from 9.6% in 2004 to 7.6% last year, is again widening. Food remains pricey but customers don't care, for M&S has shrewdly pitched its groceries at the increasingly health-obsessed middle classes as the wiser choice.

The real test for M&S is yet to come. Because its earlier drop in sales was so sharp, the company had only to reverse the fall to look good. Soon, however, it will have to better an ever-improving record. Debenhams, for its part, faces a more immediate challenge: convincing investors that its current owners haven't scooped the pot.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Local elections

Of rats and voters

Apr 27th 2006 | BIRMINGHAM
From The Economist print edition

Why the Tories and Lib Dems are prospering in Britain's second city

LOCAL elections, which take place across the country on May 4th, tend to be seen as a giant, publicly-funded opinion poll providing clues about how parties will do at the next general election. But in Birmingham it is hard to find anyone who is talking about the health service, schools, the war in Iraq or any other weighty national issue. “When I say this election is about local issues, I mean things that are going on in this ward, not in the one next door; and certainly not in the city centre,” says Amy Watson, who is standing for Labour in the Longbridge ward in the south of the city. In nearby Springfield, Roger Harmer, a Liberal Democrat councillor, is running on a pledge to employ a full-time rat catcher to hunt down the rodents who have grown fat on the rubbish from the area's numerous take-away restaurants. “It's the number-one issue people have raised on the doorstep,” he explains.

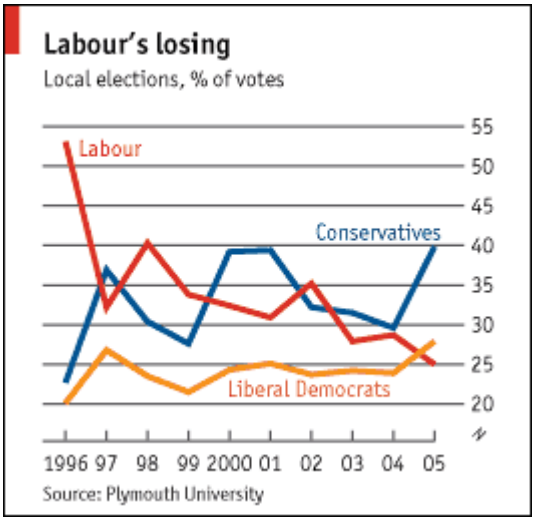
In addition to the prominence of vermin in the campaign, Birmingham's election is interesting for three reasons. First, Birmingham is Britain's second-largest city and its council is the biggest unit of local government in England. Second, all three main parties have a strong presence on the council. This contrasts with places further north like Liverpool, Manchester and Newcastle, where the Tories do not have a single councillor. Third, population projections show that Birmingham is in a race with Leicester to become the first British city where ethnic minorities will make up a majority of the population.

Labour lost control of the council two years ago, after 20 years at the helm. The town hall is now run by a coalition of Conservatives and Lib Dems. The Audit Commission, a government agency that gives gold stars to deserving councils, rewarded the new regime with an improved rating (the commission reckoned the previous Labour council was weak). The Tories are confident that they will hold on to gains they made in 2004 and stay in power, while the Lib Dems hope to pick up a handful of extra seats.

Why will it be hard for Labour to make a comeback? Part of the explanation lies in the city's complex race politics. Opposition to the Iraq war among Asian voters opened up wards across the middle of the city to the anti-war Lib Dems. Labour was also hurt by the findings of an investigation into fraud in the 2004 election, which found that some Asian Labour councillors had been collecting postal votes, taking them to a warehouse and filling them in themselves. Six were stripped of their seats and one, Arjan Singh, who was not involved in vote-rigging, subsequently defected to the Tories. (Mr Singh, a former steward of UNISON, the public-sector trade union, says he feels at home in Margaret Thatcher's old party.)

Elsewhere in the city, race politics of a different shade have made an appearance. The thuggish British National Party (BNP) has put up a candidate in every ward in the city. This, though, is more a consequence of the BNP's desire to look like a serious party than a harbinger of its

triumph.



There are signs in Birmingham of the anti-Muslim sentiment that the BNP hopes to exploit. But, just to complicate things further, its strongest expression so far has been from Afro-Caribbeans (improbable BNP voters) resentful of their more successful Asian neighbours. In fact, the party is likely to do well in only one ward, Kingstanding, which is poor, white and—crucially—a Labour rotten borough. A lack of opposition from the Tories and the Lib Dems has allowed the BNP to prosper there. It only failed to win a council seat before because the far-right vote split between the BNP and the National Front.

What will May's elections bring elsewhere? The Conservatives secured a relatively high share of the vote in recent local elections (see chart) and so start from a base that may be hard to better. And most of this year's elections are in urban areas, where the Tories are weak. Labour also enjoys an advantage in local elections that mirrors its advantage at general elections. Because boundaries have not been changed to reflect population movements, and voter turnout is normally low in safe Labour wards, labour councillors were elected in London four years ago with an average of just 680 votes apiece, compared with 900 votes per Tory councillor and 1,150 for each Lib Dem. Labour is still likely to lose control of a few councils—especially in London—but the resulting pick-up for the Lib Dems and Tories may be less invigorating than they hope.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Secondary education

Leave none behind

Apr 27th 2006
From The Economist print edition

Under-achievers raise their game

TEN years ago Paul Grant was a troubled man. He had agreed to head a school with one of the worst reputations in the country—Robert Clack, a comprehensive school in Dagenham, east London. “I did not want to fail these children,” he said. “They had become outcasts. I knew it meant toiling hard in the vineyards.”

Mr Grant's vineyards were the enormous tower blocks of the Becontree housing estate, which surrounds Robert Clack. Some pupils were engaged in open warfare with a school nearby; hundreds were playing truant; many openly smoked; and one even set fire to the sixth form.

The other schools in the borough of Barking and Dagenham were not much better. Only 27% of pupils obtained five or more good GCSEs, half the national rate. At Robert Clack only 16% reached that standard. The Ford Motor plant and others had long provided plenty of manual work in the heavily white and working-class area; Tony Travers, of the London School of Economics, reckons that the availability of unskilled employment produced a local culture in which little was expected from education. Adults in the borough are among the least educated in England and Wales. And in the last general election, the far-right British National Party did better in Barking than anywhere else in Britain.

The problem of low expectations is not unique to Dagenham. Poor children, especially white and black boys, fall behind other groups at school. Research by the Learning and Skills Development Agency, charged until recently with improving British skills, found that poor white boys begin to under-perform between the ages of 14 and 16, and black boys even earlier.

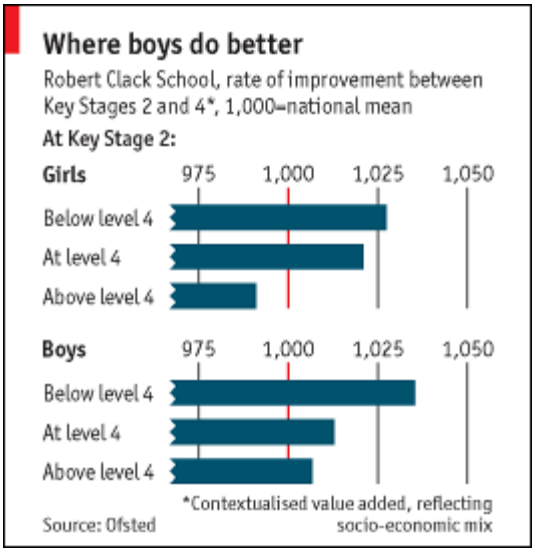
Roger Luxton, who is now head of children's services, took hold of the problem for the borough. He had seen countless initiatives fail such children, he says. He looked for pointers to the continent, particularly Switzerland, where low-achievers seemed to do better.

The borough improved lesson plans, brought in vocational studies for disaffected children and supported talented ones. In 2005, 51% obtained five or more good GCSE's, just six points below the national average though the area is poorer than most. At Robert Clack, with twice as many pupils on free school meals (ie, from poor families) as the average school, 68% got five good grades, many in hard subjects such as physics, chemistry and history.

What is most striking about Mr Grant's school, which does not select by ability, is the performance of previously underachieving boys (see chart). White boys, who make up 40% of the school's population, are improving fastest, with boys from African-Caribbean backgrounds (a much smaller group) beating expectations too.

The school-inspection body, Ofsted, recently analysed the

school's “contextual value-added” score, a national measure that takes into account factors such as the number of poor children, different ethnic groups, the split between girls and boys, and pupil turnover. It found that almost every group over-achieved compared with similar schools.



The keys to this success were discipline, motivation and stronger teaching. Mr Grant cracked down on bad behaviour, temporarily kicking out a third of the school in his first fortnight. He brought in a uniform and made pupils wear it. Achievement, which had become deeply unfashionable, was celebrated; Mr Grant threatened to throw the book at children who mocked those who did well. Competitive sports were made much of, too: one pupil is now about to sign for West Ham football club and several are in Britain's gymnastic squad. And Robert Clack has two choirs and a thriving orchestra, as other sorts of excellence were pursued. The school became a specialist school in science and clearer lesson plans were introduced. One pupil went to Cambridge University; and another is on the way.

Most important, parents were, slowly, converted to the cause. At Mr Grant's first parents' evening, just a third of them pitched up. Now 85% attend regularly. One reason is that success breeds enthusiasm; another is that the sort of unskilled work which kept food on the table is vanishing. Unemployment is nearly 10% in Dagenham, two points higher than the London average, since Ford closed its plant four years ago and axed almost 3,000 jobs. Parents know their children won't find other ones without educational qualifications—and their support in obtaining them.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The BBC 2.0

Auntie on tap

Apr 27th 2006
From The Economist print edition

The BBC lays out ambitious plans for its future online

Get article background

"UNLOCKING our archive is one of the biggest challenges we face and, potentially, one of the richest gifts we can give to the nation." So declared Ashley Highfield, the BBC's head of new media, as the corporation outlined a vision for its future on the internet this week. Its most ambitious idea is to go "on-demand", making the million programmes it has produced since 1937 available to viewers online, mostly for free. Soon it plans to introduce a new service, BBC iPlayer, to allow people to catch up on programmes they missed on its main channels.

Mr Highfield reckons that opening the vaults would be of huge cultural value. His grandfather, for instance, was a pilot who set long-distance flying records before the second world war, and his father hopes to find old footage of air shows at Hendon if the BBC's library is digitised. This week, as a first step, the BBC put a list of 946,614 TV and radio programmes on half a million different subjects up on the internet.

Those who pay licence fees would doubtless enjoy an on-demand Beeb. But the plan is controversial. Giving away programmes could deal a blow to commercial providers of video content. Under the BBC's new charter, Ofcom, the communications regulator, must examine any new service for its market impact. BBC iPlayer will be the first for inspection this summer.

Though the BBC's stated aim to nurture new media in Britain is laudable, says a person close to government, "there's a question over whether it's a pillow under the baby's head or stifling it." This week the BBC said it would re-launch its website to include more material generated by users. It wants to become the "premier" destination for unsigned bands. Commercial firms already offer similar services—Rupert Murdoch's MySpace.com, for instance, has lots of new bands. Newspaper bosses say the BBC has been stifling their online efforts for years. So far the Beeb has so much money for its website that they find it hard to compete.

Opening up the BBC'S archive, mainly for free, could amplify the corporation's market-distorting effect. Lots of popular past programmes will suddenly be available alongside its current shows. People have a limited time to goggle, and if they spend it watching old BBC favourites such as "Smiley's People", they will skip something else, which might include pay-TV or DVDs or TV financed by advertising. "Just as commercial business models are taking shape for on-demand television and new media, it would be a shame if a large free intervention by the BBC were to choke them off and stifle innovation," says Mike Darcey, group commercial and strategy director at BSkyB, a pay-TV firm.

In practice, however, Ofcom may not find much evidence of potential market impact this year. That is partly because the video market is changing rapidly, and also because people will be able

to access the BBC's archive only on their personal computers, for the time being. Commercial internet firms are not protesting. The likely outcome, says a media consultant, is that Ofcom and the BBC's governors will say yes to on-demand programming, but with conditions. The kinds of programmes that compete most directly with commercial products—drama and comedy, for example—may not be allowed.

Even within the BBC, according to a media executive, there is disagreement over the extent to which the BBC should make people pay for access to its library. Mr Highfield wants most of the archive to be free. But people at BBC Worldwide, the corporation's commercial arm, want to use on-demand access to earn more from BBC content. Worldwide already gets money from a number of pay channels which show popular old BBC programmes, in partnership with Flextech, the content arm of Telewest, a cable company. It is unclear what would happen to these channels if the BBC were to open its archive.

The most effective limit on the BBC's expansion into new media may prove to be money. The Beeb has asked for a big annual increase in its licence fee to pay for it all. This week the government published an accountant's report which says that the BBC could get by with less. Auntie may find that she cannot afford to make quite as rich a gift as she would like.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Bagehot

It's the party, stupid

Apr 27th 2006
From The Economist print edition

Before his first electoral test, there are already mutterings about David Cameron's leadership

Get article background

TORY MPs, returning to Westminster from their Easter break, don't know quite what to make of their new leader. Most were impressed by the extent of the media coverage devoted to David Cameron's trip to the melting polar ice-cap. If getting yourself noticed is half the job of an opposition leader, they concede that Mr Cameron is a natural. What they find harder to grasp is what hugging huskies has to do with putting up a decent show in the local elections on May 4th.

It would be wrong to say that the knives will be out for Mr Cameron if the results are bad next Thursday. But anything below a percentage share of the vote in the high 30s, a failure to make gains in London and an upsurge of support for the Liberal Democrats would all be grounds for disappointment. Without some good news from the polls, the muttering that has already started will grow louder.

What is clear, as one of Mr Cameron's senior supporters puts it, is that the first phase of his leadership is over. In that phase, there was an immediate boost of about five points to the Conservatives' opinion-poll rating, around 20,000 new party members were signed up and even MPs who were privately aghast at the alacrity with which Mr Cameron abandoned supposedly traditional Tory positions on tax, selective schools and private medicine kept silent. When he banged on about a range of concerns not normally close to Tory hearts, some potential foes comforted themselves with the belief that Mr Cameron was not entirely serious. Others needed

more time to work out what was going on.

Two things have changed. The first is that recent opinion polls show Conservative support falling back towards the level that prevailed before Mr Cameron took over. It is the Lib Dems, not the Tories, who have benefited from Labour's recent difficulties with dodgy loans and an unresponsive health service. The second change, according to a Cameron ally, is that people now realise that when the Tory leader talks about social justice, world poverty and the environment, “it's for real”.

Rather than assault Mr Cameron head-on over where he wants to take the party, his Tory critics grouse about a lack of substance and a preference for PR stunts over the nitty-gritty of making policy. Consciously or otherwise, they reinforce Labour's attack on him as Chameleon Dave, the flip-flopper who believes in nothing.

How worried should Mr Cameron be? As far as any threat to his position is concerned, not very. The first point in Mr Cameron's favour is that, in contrast to his three predecessors, he is neither disliked nor thought inept. Whatever the criticisms of him, they are not personal. Many of the people who profoundly disagree with his direction of travel and who yearn for a return to the old religion think they are trying to help him.

A second point is that nobody can say Mr Cameron was elected on false pretences. He was clear about what he intended to do and won an overwhelming mandate from a membership hungry to return to power. His most notable pledge, and one that he made repeatedly during his campaign for the leadership, was that however tough the going became he would not revert to the failed strategy of appealing only to core Conservative voters. Even right-wing head-bangers, convinced that the party has suffered three successive election defeats only because of insufficient ideological zeal, dimly recognise that if Mr Cameron were to follow their prescription he would lose all credibility.

Thirdly, the approach that Mr Cameron is taking is based not on whim, but on hard evidence of what will befall the party if it fails to change. Among the findings of the extensive (and expensive) opinion research that was commissioned personally by Lord Ashcroft, a former party treasurer, before and immediately after the last election, two stand out.

A survey conducted by Populus in the days after May 5th found that the proportion of ABC1s (roughly speaking, middle-class professionals) who voted Conservative was barely one percentage point more than those who said they had voted Labour. The last time the Tories won an election (in 1992), they led Labour among this group by 32 percentage points.

Polling carried out at about the same time by YouGov in the 130 most marginal Labour-held constituencies conveyed a similarly bleak message. By adding together those who were “certain”, “likely” and “possible” to vote for a particular party, YouGov found that 54% were potential Labour supporters, 51% potential Lib Dems and only 44% potential Conservatives. To stand any chance of winning an election, the Tories must first persuade a large number of people to consider voting for them who at present have entirely ruled out that possibility.

Fluff and nonsense

Finally, the charge that Mr Cameron is all fluff and no substance is itself glib. There is little to be gained from coming up with detailed policies too soon: sensible ones will be stolen and silly ones ridiculed. But the shift in language and subject matter already achieved will increasingly be backed up by ideas that can be turned into policy, such as the proposal last week for a carbon levy on business. Meanwhile, an attempt is under way to draw together the themes of various speeches into a coherent statement of what the party stands for.

Mr Cameron's internal critics pose no immediate danger to him. But they damage him (and themselves) in another way. The Tories' own focus groups suggest that although he has got people's attention he has not yet convinced them. It's partly the flip-flop fear: that he is saying things he may not really mean. Mr Cameron is quite capable of persuading them otherwise. But there is also the suspicion that even if he himself is something different, it's the same old Tory Party that he leads. Changing that all-too-accurate perception will be a great deal harder.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

American sports

In a league of its own

Apr 27th 2006 | CHICAGO
From The Economist print edition

America's National Football League offers a business lesson to other sports

Reuters

ONE of America's most closely watched annual rituals takes place this weekend, when the 32 teams of the National Football League select their next crop of superstars in the college draft. The first few players chosen—probably starting with Reggie Bush, a running-back from the University of Southern California who is rather nimbler than his presidential namesake—will then sign multi-million-dollar deals with their new teams, and field lucrative endorsement offers. Although the draft picks get all of the attention, an arguably more important selection process is quietly taking place in the background: to find a successor for Paul Tagliabue, the NFL's commissioner since 1989, who is stepping down in July.

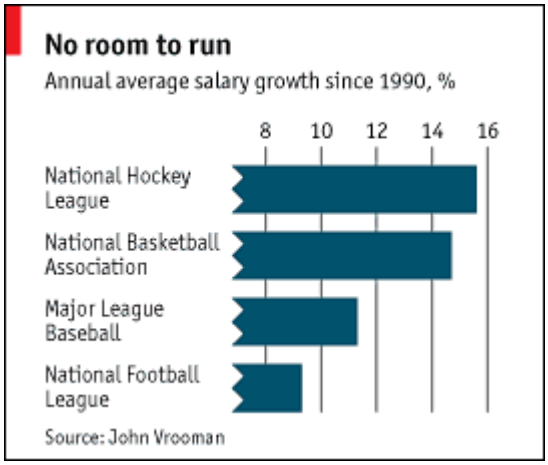
Although the 65-year-old Mr Tagliabue cannot run, catch or throw with any grace, he is in many ways the league's most valuable player. Whereas picking the right athlete on draft day can give a team an edge over its rivals for a few years, the skilful commissioner has helped the entire league to establish lasting dominance over competing providers of sports and entertainment. Condoleezza Rice has long said that she covets the job; but sadly for Miss Rice, she has other duties at the moment. Whoever the owners choose, however, will need a diplomat's ability to mix coercion and consensus, since the commissioner's job is to sustain one of the world's most effective cartels.

The success of the NFL syndicate stands in stark contrast to the troubles of America's three other main sports leagues: for baseball, basketball and ice hockey. Whereas the NFL's players have not walked out since 1987—before Mr Tagliabue took over—the other three leagues have all faced crippling labour strikes since the mid-1990s, the most recent of which cost the ice-hockey league an entire season last year. As a business, American football has been beating its rivals handily for

years. It has the highest total revenues of the four, at nearly $6 billion a year. It has the firmest grip on its labour costs, which have grown only 9% a year since 1990, compared with 12-16% growth in the other three leagues. It remains the most popular of the four big American sports on almost every measure, from opinion polls to television ratings. And it has translated all of this into rising profits. The average football team has a market value of around 3.9 to 4.4 times revenues, compared with ratios of 2.2 to 3.0 for the other leagues.

What is the NFL's secret? Running a sports league is an awkward endeavour, since the owners must co-operate on many business decisions despite fielding teams that compete fiercely. Aside from this quirky element, however, many of the NFL's fundamentals are similar to those of successful firms in other industries: its internal incentives point in the right direction; it has had good leadership for a long time; it has been lucky; and it has followed a sensible growth strategy.

Two sets of incentives have been especially important: the teams' owners share roughly 70% of their revenues with each other; and they stick to a strict salary cap that limits the amount each team can spend on players' salaries. It is little wonder, then, that Art Modell, the former owner of a franchise that moved from Cleveland to Baltimore, once referred to NFL team owners as “32 fat-cat Republicans who vote socialist” on football. But these two policies, taken together, have done wonders for profits, by giving all 32 owners a chance to field teams that are both financially viable and athletically competitive, even though some are in much richer local markets than others. The contrast with English football's Premier League—the richest soccer league in the world—is striking. The lack of a salary cap and the fact there is little revenue sharing means that the league is dominated by the same teams, year after year, while the poorer and less successful teams lose support and flirt with bankruptcy.



But the NFL also stands out when compared with the other three big sports leagues in America. While they let teams in New York and other big cities capture giant local media markets, the NFL negotiates all of its television contracts as a single entity. Its latest contract, which will run until the end of 2011, will bring in $3.7 billion a year from several national networks, which Mr Tagliabue and the league have artfully pitted against one another.

By getting the co-operative bits right, the NFL as a whole benefits in two ways. First, its teams are far more evenly matched competitively than those in other leagues. Several teams rise and fall in the league tables from one year to the next, and every season provides many fresh examples of how any team can win on “any given Sunday”. That keeps supporters coming back, and ensures that the bulk of the games remain interesting, even in the final weeks of the season.

Second, the system lowers risk. “The NFL is a perfect portfolio,” says John Vrooman, a sports economist at Vanderbilt University, because one team's losing season and sagging revenues are offset by another team's banner year. The co-operative arrangements also make costs stable and predictable. Mr Vrooman reckons that even if another American sports league, or a big European football league, were to have similar cashflows to the NFL, the American league's teams would still be 50-60% more valuable because their business is so much less risky.

Unsurprisingly, the NFL's rivals have been trying over the past few years to imitate its winning business model. The baseball league, for example, has adopted a limited form of revenue sharing, but not enough to eliminate the gap between wealthy teams such as the New York Yankees and

perennial small-town losers such as the Milwaukee Brewers. The ice-hockey league's owners, after weathering last year's strike better than the players, put in place a new contract with some salary limits and revenue sharing. But it did not go far enough, because the owners of the wealthiest teams were unwilling to compromise for the sake of the cartel.

That is where leadership and luck come in. The hockey league's commissioner, Gary Bettman, is not nearly as adept or respected as Mr Tagliabue—who deftly thrashed out a bargain recently to renew the labour and revenue-sharing system for several more years—and was thus unable to forge a better deal. The NFL is also lucky—and its athletes much less so—because it is the most violent of the four sports. Since the average player does not last more than four years as a professional, labour strikes are difficult and the union is weak.

The trouble with revenue sharing, however, is that it can encourage free-riders. Daniel Rascher, the president of Sports Economics in Berkeley, California, points out that the Cincinnati franchise was the NFL's fifth-most-profitable during the 1990s, despite winning the fewest games during the decade. The team simply skimped on avoidable costs, such as talent scouts, and raked in revenues from the rest of the league.

Although there will always be a couple of Cincinnatis, however, the NFL has managed to limit this problem by letting individual teams keep all of the revenue streams from a couple of high-growth segments, such as luxury boxes. That gives each owner an incentive to invest in a new stadium—17 have been erected or overhauled on Mr Tagliabue's watch—that is designed with profit margins in mind.

Like any good syndicate, the NFL under Mr Tagliabue has also mastered politics. Mr Vrooman points out that the league likes to leave one prominent city without a football franchise, “like an empty seat in musical chairs”, so that teams in other cities can threaten to move if they do not get their way. This invariably prompts state and local governments to contribute public money to help teams that replace old stadiums with new ones. Los Angeles residents have been scratching their heads about why the country's second-largest city has had no football team since 1994. But the NFL has made far more money from new stadiums that have been built using Los Angeles as a threat, says Mr Vrooman, than it could have made by actually putting a team there. There is a lesson in all this for Mr Tagliabue's successor: competition is nice, but if you want it to be profitable, it helps to write your own rules.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Steel

Arcelor, up in arms

Apr 27th 2006 | PARIS
From The Economist print edition

Arcelor's dubious defence against Mittal Steel's hostile bid

Get article background

GUY DOLLÉ is no diplomat. When Lakshmi Mittal, boss of Mittal Steel, the biggest global steelmaker by volume, launched a hostile bid at the end of January for Arcelor, the second-biggest, the boss of Arcelor immediately rejected it—and in rather robust terms. Mr Dollé claimed that Arcelor is producing aristocratic perfume whilst Mittal is making plebeian eau de cologne. He pretended there was no industrial logic to the takeover plan. And he even said that he did not want his shareholders to be paid with the Indian-born Mr Mittal's "monkey money".

Reuters

Dollé waves aside the monkey money

Most of Mr Dollé's arguments were easily dealt with during the battle for shareholders' hearts and votes that he and Mr Mittal have been waging over the past months. The industrial logic of a merger of two companies that complement each other in geography and in the type of steel they produce is compelling. Mittal is big in America and emerging economies that demand lower-quality steel while Arcelor is a European company, producing mainly high-quality steel. The industry is consolidating. If Mr Mittal succeeds, he will create a producer more than three times the size of its nearest rival and as big as the entire Japanese steel business.

Even the chorus of patriotic opposition has died down. Politicians in Spain, Luxembourg and France—Arcelor's most important bases—are starting to see the advantages of a global champion. And they increasingly see that they have little power to block a merger of two private firms.

Mr Dollé had one good argument to wield against the Mittal bid. The steel giant's corporate governance is not fair to minority shareholders. The Mittal family controls 88% of the firm's shares and each of their shares carries ten votes. Three members of the clan—Mr Mittal, Aditya, his son

who is also the company's chief financial officer, and Vanisha, his daughter—sit on the company' s nine-member board. Mr Mittal says he will rethink multiple voting-rights for shares—after the merger.

Arcelor's governance on the other hand used to be exemplary. But over the past few weeks Mr Dollé has taken actions that suit him, rather than his shareholders. His first move to frustrate the Mittal bid was to transfer ownership of Dofasco, a recently acquired Canadian steelmaker, to Strategic Steel Stichting, a newly formed Dutch foundation. Mr Mittal intends to sell Dofasco to ThyssenKrupp, a German steelmaker, to avoid trouble with antitrust authorities and because Mittal is already a big force in North America. This will now be tricky: the Stichting is run by an Arcelor executive, a former Arcelor executive and an American lawyer, who have the power to decide whether Dofasco can be sold in the next five years. Mr Mittal says his lawyers are looking into how to undo the trust.

To placate investors who might question the decision to ring-fence such an important asset, Arcelor raised its dividend by 54%. It will also make a special €5 billion payment to shareholders if Mr Mittal drops his bid or the takeover attempt fails. The two payouts make siding with Arcelor roughly as financially attractive to shareholders as accepting the Mittal bid. But Arcelor's debt will balloon as a result of the special dividends. Mr Mittal says this is not in the long-term interest of shareholders.

Perhaps more tellingly, shareholder activists are up in arms. Institutional Shareholder Services, an American corporate-governance adviser, is recommending its clients oppose the re-election of Arcelor's chairman and deputy chairman. Colette Neuville, boss of ADAM, a French shareholder-rights association, who says she represents about 5% of Arcelor's shareholders, intends to vote against re-electing 16 of the 18 Arcelor board members.

Shareholders will probably not muster enough support to topple the board, but they may make other investors think harder about the Mittal offer. Mr Mittal intends to bid formally for Arcelor in the next couple of weeks. Shareholders will have 35 days to decide. Mr Mittal hopes the outcome of his bid will be clear by the end of June. So does Mr Dollé who has already booked his holiday for July. One of them may have a rather joyless summer.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Toll roads

Merging lanes

Apr 27th 2006 | ROME
From The Economist print edition

Italy's Autostrade and Spain's Abertis get together

THERE are no synergies to be exploited and no overlaps to be tackled. Instead the merger agreed between Autostrade, an Italian toll-highway operator, and Abertis, its Spanish equivalent, announced on April 23rd, is about sheer size—as well as a tidy profit for some of the big shareholders involved.

AFP

Next stop, Barcelona

By far Italy's largest company in its industry, Autostrade operates around 3,400km of highway. The combination with Abertis will create a concern that operates around 6,700km of highway. Together, the companies had €6 billion ($7.45 billion) of revenues last year, on which they posted operating profits of €3.8 billion. Italy and Spain will be giving birth to a world leader in infrastructure management, say the two chairmen, claiming that the resulting company will spur the Italian and Spanish economies into overdrive.

But if the merger offers no economies of scale, and little scope for rationalisation, where are its advantages? According to Autostrade, the two companies will together have the industrial and financial weight to exploit global opportunities, like those in central and eastern Europe as countries there develop their toll-highway networks.

However, cynics think that the merger's biggest benefit will be reaped by Autostrade's controlling shareholder, Schemaventotto, an investment vehicle in which the Benetton family has a 60% interest and Abertis itself has 13.3%. Under the merger agreement, Autostrade's shareholders will be paid a special dividend that will be worth about €650m to the Benettons.

Enrico Letta, the opposition industry spokesman in the last Italian parliament, complains that the

merger was timed to take advantage of Italy's current political vacuum. “And it is presented as a merger of equals, but that is not true. This is the first step in an Italian sell-out to Spain,” he says. The merged company will have its headquarters in Barcelona and its first managing director will be Abertis's boss. The Italians are sensitive to the idea that their slow-moving economy risks being overtaken by fast-moving Spain—which a generation ago was a much poorer and less-developed country.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Business-school deans

Light on their feet

Apr 27th 2006
From The Economist print edition

The heads of business schools are becoming like sports coaches

BUSINESS-school deans are on the move. In the 1980s and 1990s it was not uncommon for them to stay in the same job for a decade or two. Now the average tenure is three to five years. Bill Funk, a headhunter at Korn Ferry who searches for many of them, says with no little glee—"We marvel at the turnover".

Three of the world's best schools—Harvard Business School (HBS), INSEAD (at Fontainebleau near Paris) and the London Business School (LBS)—are all currently "redeaning". On April 24th HBS announced that Jay Light, a finance professor who had been acting dean at the school since last August, would henceforth stop acting and become the real thing. At INSEAD a new dean, Frank Brown, an American, takes over at the end of May. LBS's American dean, Laura Tyson, has announced that she will not renew her five-year contract when it expires at the end of this year. The search for her successor is already well underway.

Deans are moving more frequently in part because the demands of their job have changed. Gone are the days when their main responsibility was the administration of students and faculty. Now a dean is expected also to be a full-time fund-raiser, the project manager of a significant on-campus property development (which dangles before generous alumni the promise of lecture theatres or libraries bearing their name), and (crucially) the guardian of the school's position in the all-important league tables published by the likes of the *Wall Street Journal*, *BusinessWeek* and the EIU, a sister company of *The Economist*. This is a demanding menu.

Although Mr Light, a low-key 64-year-old, was originally a temporary appointment who was meant to keep things ticking over, he had performed well on all three of these tests. HBS ended an all-time record $600m fund-raising campaign, retained its place at (or near) the very top of the league tables, and completed a $25m restoration of its revered Baker Library during his short spell at the helm.

What his CV lacks, however, is some sort of international experience. As European schools such as LBS and INSEAD turn to America for their deans, so American schools are looking overseas. Dipak Jain, dean of the prestigious Kellogg School outside Chicago, one of HBS's closest rivals, was born and raised in India. He is also a visiting professor at universities in Germany and Thailand. Would-be MBA students today are keen on schools that can give them a global perspective. They are also at least as keen on where they study as on what they study, and they watch the schools' movements in the league tables with intense interest. Mr Funk says that this attention to rankings has put deans into the same league as sports' coaches.

The pay is less, but it too is on the move. Business-school deans are now almost as well paid as university chancellors. At an average school in America a dean can earn $250,000-$300,000 a year; at blue-chip establishments they get considerably more. Mr Light is expected to earn over

$500,000 a year, plus considerable perks.

The obsession with league tables is giving birth to a new breed of dean. Until recently, they have fallen into one of two camps: the academic who tears himself away from research for a while, a camp that includes Mr Light; and the (rarer) outside manager/administrator, such as INSEAD's Mr Brown, his school's first non-academic in the job.

The new breed of dean is different from these two. He is a sort of freelance professional who shops around a bit like a sports coach. Robert Sullivan, dean of a new business school at the University of California, San Diego, is on his third dean-ship in a decade, as is George Daly, dean of the McDonough school at Georgetown University. Earlier this year Yash Gupta, the Indian-born, British-educated dean of USC's Marshall School, resigned after only 19 months on the job—his third dean's post in six years. He said that his public search for the next step on his career as a professional dean had made it difficult for him to stay in office at the Marshall School. It must be hard working for the San Diego Padres when everyone knows you are after the top job at the New York Yankees.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Internet video

Clip culture

Apr 27th 2006 | SAN MATEO
From The Economist print edition

A start-up shows big media and mighty Google how to do web video

CHAD HURLEY and Steve Chen, two modest twenty-something software geeks in Silicon Valley, were at a dinner party last year where several people brought their camcorders and then complained how difficult it was to share home videos online. So they did what one does in their circles. They founded a company, called YouTube; got a few million dollars from Sequoia Capital, an eminent venture-capital firm; wrote some code in Mr Hurley's garage; and then moved into a San Mateo loft that resembles an office. Their simple idea was to make uploading home videos to the internet easy.

It turns out that millions of people already had such videos and were just waiting for a way to share them. Even before YouTube's official launch last December, the site contained more than a million short video clips. In December people were uploading 8,000 clips a day, and watching 3m a day. This month they were uploading 35,000 a day and watching 40m a day. With such amazing growth—almost all by word of mouth, e-mail and hyperlink—YouTube already has four times the traffic of Google Video, the online video market of the world's largest search-engine firm, and the nearest thing to a rival.

YouTube's success is therefore of great interest to many older and larger companies. Web video has over the past year become the next “next big thing” on the internet. A survey by the Online Publishers Association in February found that 69% of American internet users have watched video on the web, 24% do so at least once a week, and 5% every day. Almost every big internet company, from portals such as Yahoo! to retailers like Amazon, now has plans to offer video search and feeds. The traditional media companies—owners of video libraries—are interested too. Walt Disney is about to make several shows from its ABC television network available without charge (ie, with advertising) on a new web cinema. CBS already offers some of its shows online for 99 cents.

This may appeal to younger audiences, since it allows “time-shifting”, so that viewers can watch when it suits them, as opposed to when the show is on air. Apple Computer was the first to understand this—it struck a deal with Walt Disney last autumn to provide some television shows on iTunes, its online music store, so that people can put them onto their iPods.

But the success of YouTube points to another development. People are spending an average of 15 minutes on the site during each visit, enough to view several short, funny clips. This is because they are using YouTube for little breaks during a dull workday. And it is a “lean-forward” experience, as people sit in front of computer screens. This “clip culture”, as Mr Hurley calls it, is quite different from the “lean-back” experience of enjoying a half-hour show while reclining on the sofa. So different that YouTube sees Hollywood as a potential ally, rather than as a threat. For instance, the producers of “Lucky Number Slevin”, a new film with Morgan Freeman, Lucy Liu and Bruce Willis, are marketing it by making the first eight minutes exclusively available as a clip on YouTube.

This emerging clip culture is also a supply-side phenomenon. Only 10% of the clips on YouTube are from film-industry “professionals”, says Mr Chen. About 80% come from rank amateurs, and another 10% from “dedicated amateurs”, such as young comedians hoping to use internet celebrity as a way into a career. Unlike the big media companies looking to recycle their film libraries, Google Video and YouTube are simply giving ordinary people a way to share clips. And compared with big, frightening Google, which Messrs Hurley and Chen consider arrogant, little YouTube seems to be doing it a lot better.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Chinese cinema

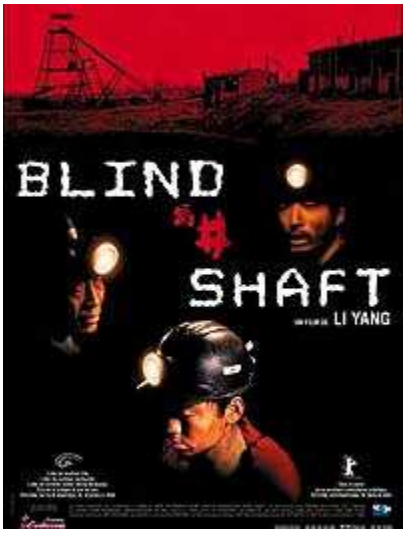
No direction

Apr 27th 2006 | HONG KONG
From The Economist print edition

Everyone is in love with Chinese cinema. Except the Chinese

THE Chinese are hot in Hollywood right now. At last month's Oscars Ang Lee, who hails from Taiwan and is a hero in mainland China, won the best director award for “Brokeback Mountain”. “Memoirs of a Geisha”, which carried off a further three Oscars, starred Gong Li and Zhang Ziyi, two Chinese actresses playing Japanese courtesans. Tom Cruise, Ewan McGregor and Nicole Kidman are all making films in China. And Britain's Merchant-Ivory studio has just released “The White Countess”, the first western picture to be shot entirely in China.

It looks like a remarkable comeback for a film industry that was destroyed by the Cultural Revolution after a glorious early debut. Chinese cinema was born in 1896, just a year after it was invented in France. Yet between 1966 and 1972 not a single film was made on the mainland. Last year there were 260, almost twice as many as two years ago. Only America (425) and India (over 800) produced more. Box-office receipts have also been growing fast, reaching 2 billion yuan ($250m) in 2005, up a third on a year earlier, according to the State Administration of Radio, Film and Television (SARFT), the government ministry-cum-regulator. Those figures pale beside the $23 billion that Hollywood raked in last year. But they compare decently with estimated receipts of $266m for India's Bollywood in 2004.



Unseen in China

Like many a Californian starlet, however, the Chinese film industry is not as healthy as it looks. Zhang Hongsen, deputy director of the film bureau at SARFT, admitted this month that only 90 of those 260 films were ever screened in China. Many had to be withdrawn days after their release because of a lack of interest among cinema-goers.

A dearth of screens is partly to blame. China has only around 3,000 cinemas, with less than a tenth of the screens in America for a population five times as big. Much of the countryside is not covered. All in, China's 1.3 billion people managed a mere 200m cinema visits last year.

But the fault also lies with the quality and price of Chinese cinemas. Fewer than half of them are modern, reckons SARFT. The new ones charge a whopping 40-120 yuan ($5-15) a ticket, so are affordable only to the middle-classes. Xiang Yucheng, general manager of Kodak Cinema World, a 930-seat luxury cinema in Shanghai, says his average occupancy at just 20-24% is one of the highest in the country. No wonder China has never developed “a popcorn culture”, says David Wolf, a Beijing-based media consultant.

A more fundamental problem is that the industry is not making the films that people want to watch. Like nearly everyone else, the Chinese adore Hollywood blockbusters. “Titanic” is the biggest-grossing film in Chinese history and the fourth “Harry Potter” adventure is the favourite today. Yet only some 20 foreign films a year are allowed into China—although that number should rise to 40 in 2006 under the country's commitments to the World Trade Organisation.

Even then, though, choice will remain limited. China's censors are as prudish and culturally conservative as they are politically repressive, preferring bland family fare from overseas. Horror, violence (unless of the kung-fu variety) and anything challenging are ruled out. Since China has no proper ratings system, every film must be suitable for all. In a speech last December marking the centenary of Chinese cinema, President Hu Jintao left no doubt that censorship would stay: “All those working with China's film industry should stick to the correct political direction all the time,” he said. Neither “Brokeback Mountain”, with its homosexual theme, nor the Japanese-centred “Geisha” were screened in China. Mr Xiang, whose own cinema is barely profitable, says he could charge a third more to exhibit those films: “I just don't have enough good movies to show.”

Many domestic films are also banned. Directors are eager to comment on the rapid changes in Chinese society. But films such as Li Yang's “Blind Shaft” (a bleak, compelling picture about life in China's illegal coal mines) and “Cry Woman” (whose heroine uses her distinctive wail to become a professional mourner and buy her husband out of jail), were not shown to local audiences even though they had been acclaimed abroad. Liu Bingjian, the director of “Cry Woman” gave up, and now sells men's beauty products for Amway, laments Zhang Xianmin, a professor at the Beijing Film Academy.

A little help from the state

Even those Chinese films that survive the censor's blue pencil and are more than mere propaganda, often fall at the next hurdle: promotion. Budgets are low, advertising costs are high and marketing in China is haphazard. As Mr Wolf points out, “There is no studio system as in America where films must pass a series of executives judging their commercial viability. China needs its own Steven Spielberg—someone who really knows what people want to see.” Most Chinese remain glued to the television and opt to watch the latest pictures on pirated DVDs, which, at 10 yuan each, cost a fraction of a cinema visit and deprived American studios of $2.7 billion of revenues last year.

In response, the Chinese government is doing what it typically does to generate growth—build infrastructure. Cash has been found to set up mobile cinemas in rural areas, while businesses in Hong Kong and Macau were told in February that they could set up 100%-owned cinema chains. The same privilege should eventually be extended to western companies such as Warner Bros, the first foreign firm to get into film distribution on the mainland—it operates several cinemas there including a huge new complex in Chongqing, a city of 30m people. With cinemas being built from scratch, there are opportunities for foreign providers of the latest technologies, such as Imax, which is already selling 3D systems in China, and Texas Instruments, with its digital projectors.

New hardware, however, does not foster creativity. What the Chinese film industry needs is less regulation and greater competition. That would mean allowing in more western films, curbing censorship and removing the onerous cap that limits foreign-studio profits to 17% of Chinese box-office receipts. If a reliable ratings system replaced the censor, domestic filmmakers could take more risks, attract bigger audiences and plough back their growing revenues into marketing and more projects. If all that happened, even the Chinese might start to watch Chinese films.

Face value

Texan sangfroid

Apr 27th 2006
From The Economist print edition

Rex Tillerson, the new head of Exxon Mobil, thinks soaring oil prices are no big deal

AP

THESE are dramatic times in the oil business—but you wouldn't know it from speaking to Rex Tillerson, who took over as the head of Exxon Mobil at the beginning of the year. Over the past five months, the price of oil has hit $75 a barrel, Exxon has announced the biggest profits in corporate history, and George Bush has declared his intention to overcome America's addiction to the stuff it peddles. Yet Mr Tillerson claims that none of this upheaval has much bearing on how Exxon is run. The firm will stick to the same strategy, he insists, making the same investment decisions based on the same assumptions about the future of the industry as it did last year. In fact, he goes even further: Exxon's strategy has not changed since 1998, when oil sold for as little as $10 a barrel.

That is quite an assertion at a time when many are arguing that the oil industry is on the verge of a cataclysm. Skittish analysts fear that the big Western firms will run out of oil, or be turfed out of their most lucrative fields by nationalist governments, or see high prices erode demand and stimulate the development of alternative fuels. Even more optimistic souls assume that oil will remain dear for some time to come, justifying lavish spending to develop marginal reserves in difficult terrain. But as far as Mr Tillerson is concerned, this is just the typical hyperbole that always accompanies upswings in oil's boom-and-bust cycle.

As a lifelong oilman, Mr Tillerson should know. He grew up in a former oil boomtown, Wichita Falls, Texas (“the city that faith built”). He has worked for Exxon for the past 31 of his 54 years. In fact, he joined the company straight out of the University of Texas, where he had studied engineering.

During the course of his career, he has managed oilfields everywhere from Arkansas to Yemen.

What is more, Mr Tillerson is the chosen successor of Lee Raymond, Exxon's previous boss. Mr Raymond's 12-year tenure was a period of unparalleled success for the company. Its market capitalisation rose from $80 billion to $360 billion, making it the most valuable listed firm in the world. (It has added another $30 billion-odd since Mr Tillerson took over.) Ruthless financial discipline underpins that rise: last year, for example, Exxon earned 31 cents on every dollar it spent, half as much again as its nearest rival, BP. That helps to explain those record profits, of more than $36 billion last year.

Exxon pursues only projects that will turn a profit even in the leanest years, Mr Tillerson explains; so in the fattest ones, the returns are eye-catching. True to that policy, he will not be seduced into making expensive investments on the assumption that the oil price will remain high. Indeed, he assumes the reverse: that it will inevitably fall. Traders, he argues, are pushing the price up on speculation about possible future supply shocks, rather than any actual shortfall. Exxon, after all, refines even more oil than it pumps, yet has never had any trouble buying supplies to feed its refineries.

Anyway, oilfields take so long to develop, and are in production for such a long time, he says, that the oil price of the day, whether high or low, “is almost entirely irrelevant” to investment decisions. So last year, despite the high price, Exxon returned more money to its shareholders than it spent on exploration and development. But in the late 1990s, when the price was in the doldrums, Exxon did the reverse, starting construction on several of the projects that are only now coming onstream in West Africa and the Arctic.

Although the oil price has risen sevenfold in the intervening years, Mr Tillerson claims that the threshold at which Exxon considers a project commercially viable has not budged at all. The firm revisits a scheme that it has previously discarded only if improvements in technology change its economics—not simply because the oil price has spiked.

Despite this choosiness, however, Mr Tillerson maintains that Exxon is not short of opportunities. Far from being shut out of the best real estate by nationalist governments, it is helping to tap the world's biggest gas field in Qatar, and has just signed a deal to develop an oilfield in the United Arab Emirates. Unlike most other Western firms, it recently sold its stake in a Venezuelan field rather than submit to higher taxes—suggesting that it is not desperate for oil to pump. Exxon estimates its total “resource base” of possible, probable and proven reserves at 73 billion barrels, which would last 49 years at the rate it is pumping.

There is a self-serving political element to this line, of course. If Exxon's record profits are the result of years of shrewd and disciplined investment, rather than an unexpected and undeserved windfall, it is harder to argue, as some American politicians have, that they should be taxed away. It is also harder to complain about Messrs Raymond's and Tillerson's record pay.

Untroubled by addiction

By the same token, if there is still plenty of oil in the ground, then there is less reason to worry about America's or any other country's addiction to it. And if there will still be plenty of cheap fossil fuels around in 30 years, then those who are worried about global warming should concentrate on making them cleaner, rather than dabbling in alternatives such as biofuels.

All the same, Mr Tillerson is making a genuine—and risky—choice. Some rivals, such as BP, are piling into renewables such as solar power. Others, including Chevron, have bought rival oil firms despite the cost. Still others, such as Royal Dutch Shell, have rapidly increased their spending on

exploration and development. But Mr Tillerson says that he plans to run the company without making any bets on the oil price. That, in itself, is a gamble: if it remains high, and he sticks to his guns, then Exxon will lose ground to its competitors.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com FINANCE & ECONOMICS
PRINTABLE PAGE VIEW SPONSORED BY

Goldman Sachs

Behind the brass plate

Apr 27th 2006 | NEW YORK
From The Economist print edition

An investment bank's magical hold at the summit of its industry

SHAREHOLDERS who attended Goldman Sachs's sixth annual meeting as a public company on March 31st had two main reasons for wanting to be present: to express thanks for Goldman's ability to produce vastly more profits than anyone ever imagined possible; and, if they were really lucky, to gain some new insight into how that success was achieved.

The secret of Goldman's success is the stuff of constant speculation, above all among the investment bank's competitors, none of which has come close to matching its sustained record of superior performance. Back before Goldman went public in 1999, the firm was looked upon with a certain awe—a secretive, private partnership, the last truly large such entity in American finance, that consistently minted money without having to disclose anything. In 2006, despite public filings that are so large they can be more easily measured in weight than in pages, Goldman Sachs remains just what it was in 1999, only more so: it is a hugely profitable enterprise—return on equity during the first quarter of this year approached 40%, notwithstanding a compensation scheme for employees that would make the old partners jealous; and it remains something of an enigma.

Over time, that enigmatic quality has only increased, defying predictions that the greater transparency supposed to accompany going public would reveal to the world Goldman's secret formula. In part, this is deliberate. Its primary source of profit has shifted from banking to trading, and the firm is intentionally quite vague about how, and precisely where, those trades are made or, equally relevant, from whom the profits are coming. One line in its accounts, “fixed income, currency and commodities” (referred to as FICC) accounts for a huge chunk of revenues (see chart 1) and this is because...well, no one outside Goldman knows exactly why.

Adding to the fog, the Goldman that exists today is quite different from the one of a decade ago, when its results were opaque but its operations were primarily American, with an emphasis on standard investment-banking services such as underwriting, brokerage and merger advisory. Today, non-American revenues are growing particularly fast and should exceed 50% of the total before long. More than a third of the firm's profits come from activities that either did not exist at the time of the public offering or were too small to matter. Inevitably, these businesses, such as derivatives, brokerage for hedge funds, swapping power-plants, and the like, are hard to understand and harder still to predict.

Spot the growth 1

Goldman Sachs's performance

$bn, revenue

	2001	2005	CAGR* 2001-2005, %
Investment banking	3.84	3.67	-1.1
Sales & trading	9.99	14.13	9.1
Fixed income	*4.05*	*8.48*	*20.3*
Equities	*5.94*	*5.65*	*-1.3*
Securities servicing	1.13	1.79	12.2
Principal investments	-0.62	2.23	na
Asset management	1.47	2.96	19.0
Total	**15.81**	**24.78**	**11.9**

Source: Boston Consulting Group

*Compound annual growth rate

Goldman is more dependent on trading for its profits than most of its rivals. It puts more of its capital at risk. Today's business focus increases the importance of managing conflicts of interest with its customers to unprecedented levels. So far, Goldman has been remarkably adept at avoiding the snares that have caught its rivals. But it should not be taken for granted that Goldman will remain Wall Street's number one.

There is a certain irony that one of Goldman's great strengths is its expertise in arranging mergers. One of its wisest decisions has been (largely, but not entirely) to evolve organically, rather than following industry fashion, as with its nearest rival, Morgan Stanley, which chose to merge with Dean Witter in 1997. Instead, Goldman has recently evolved mostly in ways that involve taking on far more risk. This is not immediately obvious. As Goldman's profits have increased, its credit rating has too. Not once since its public offering has its return on equity slipped below 10%, a stunning accomplishment given years in which equity markets tumbled, underwriting evaporated, the economy seemed briefly to go into recession, and the September 11th attacks brought down two skyscrapers just blocks from its headquarters. Even so, the firm's balance sheet, strategy and reputation are all becoming steadily more stretched.

One of the attractive qualities of old-fashioned investment banking over most other businesses was that, as a pure intermediary between companies that had a need for money and investors that had a need for return, demands for capital were minimal—desks, telephones, and a bit of money to support securities for the brief time it took to transport them from the issuer to the holder. Goldman had long been a bit different, because it put its own capital at risk in a successful arbitrage desk. But its recent evolution has pushed this need for capital into the stratosphere.

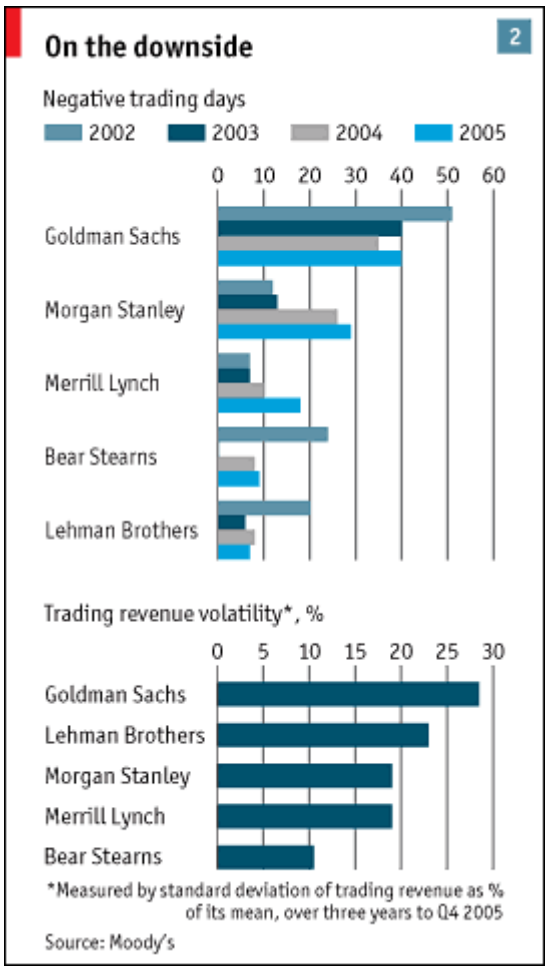
Fingers in every pie

These days, Goldman applies capital not only to what has traditionally been perceived as proprietary trading—punts on the market—but to other businesses as well. Some of these, such as executing trades for clients in return for a commission, used to have no risk at all. With increasing frequency, investors no longer want a straight broker. They want someone to take on the risk of the transaction, and that someone must put up money and possibly suffer losses or make an outsized gain. For a firm that is in a position to see what is going on in the markets, and Goldman through its various trading entities touches about one-third of all the share trades in America's financial markets, this can be an excellent business. But bad things occasionally happen.

Goldman's public offering was delayed because of the implosion in 1998 of Long-Term Capital Management, a heavily leveraged hedge fund, and the resulting financial chaos. In the aftermath,

it vowed to bring down its financial risk, but it has since risen almost back to its peak. Similarly, over the past two years, Goldman's “value at risk”, or the amount it can lose in a really bad (but not really, really, really bad) day has risen strongly. And for all its trading prowess, even Goldman does not make money all the time. Its trading desk has more “losing days” than any of its Wall Street rivals (see chart 2).

Recent years have not been kind to the standing of investment firms. No company talks about ethics and principles more than Goldman, and scanning headlines it is easy to believe that Goldman has avoided the scandals that have besieged its rivals. In truth, its success has been relative, not absolute—a result of brilliant public relations, the egregious follies of others, and, possibly, particularly good lawyers.



In Goldman's latest 10k, a filing to the Securities and Exchange Commission, there is a 10-page densely written chapter on pending legal claims that is a list, of sorts, of the firm's stupid underwriting, questionable moves and ongoing actionable risks (meaning there are probably many more at earlier stages), tempered a bit by the reality that any wealthy firm faces extortion from plaintiff lawyers.

From a purely legal perspective, none of these claims is likely to do Goldman in, nor for that matter hurt it much. Indeed, legal settlements favour the big established firms because they have typically been structured to cause a bit of financial pain but no permanent damage. Only big firms have the resources and experience to provide the requisite compliance. But might these claims, if substantiated, put off clients? Should they?

One of the great concerns at the time of Goldman's offering was, appropriately enough, the pressure of meeting quarterly earnings from Wall Street. The fear was that these would shift its approach from, in the famous phrase of its former leader Gus Levy, “greedy, but long-term greedy,” to the more conventional sort that could destroy its standing with clients. Whether Goldman was, in fact, really different in its approach to vice, or virtue, than any other Wall Street firm is the cause of some debate, but beginning in the 1960s the bank graduated from the second-tier to pre-eminence at least in part because it was perceived by its clients as the one to trust. Symbolically, for years it advised on few hostile takeover bids.

This role has, theoretically at least, become increasingly tenuous as Goldman has moved from being mostly an agent (as an underwriter) to a principal, as a trader and direct investor. Inevitably, in setting a price either for a security or a company that it might buy or sell, Goldman is no longer looking after only its client's interest. Indeed it has become harder to distinguish between who is a Goldman client and who is a Goldman competitor.

Examples abound. Would General Motors be better off if Goldman had merely sought out a buyer for the property arm of its financing operation, instead of itself joining the buy-out group, as it recently did? The bank cites numerous times when it advised on a deal and then provided a hedge of some sort that immunised the buyer from a risk. Presumably from the buyer's point of view,

Goldman's profit from the hedge (which is often the most lucrative part of the deal) is irrelevant, except that it means Goldman as an adviser was not looking out only for the client. Is this bad? It is a matter of judgment.

In terms of its investment banking, Goldman now finds itself on so many sides of a deal simultaneously that the mind boggles. Goldman's merchant-banking arm competes with clients (and counts them as customers), and its proprietary arm may trade against them. At the same time as it represents a firm, it could be shopping it for sale, attempting to buy it itself, or competing for an acquisition on behalf of another client. Occasionally—but only occasionally—these roles become so apparent that the conflict becomes public.

Interesting conflicts

The most cited example is its role in the recently completed merger of the New York Stock Exchange and Archipelago, where it represented both sides while having an ownership stake in one, an ex-chief operating officer on the other, and an underlying business (trading) which had customers whose interests in competitive markets potentially diverged from Goldman's own interest in consolidation. In America this is considered banking nirvana—fees from all sides and clients who, mostly, do not recoil. Elsewhere these kinds of conflicting interests come with costs. In Britain several unsolicited offers from Goldman's private-equity group have cost it at least one customer and caused a flap. In Japan a series of successful direct investments by Goldman has caused its standing in merger advisory to plunge as companies shy away from sharing information with a possible bidder. This aggressive approach is thought to have contributed to a minor regulatory complaint that, in turn, led to the cancellation of Goldman's contract as the sole non-Japanese firm distributing funds through the country's massive postal savings bank.

Mostly though, Goldman's formidable reputation works in its favour. One of its fastest-growing businesses has been proprietary asset management, an area it once avoided out of concerns that it would create conflicts with the institutional money managers who were prized clients. Goldman argues that the business offers genuine advantages. Clients can join in merchant-banking deals that would otherwise be unavailable, and have access to hedge funds.

This assumes, however, that Goldman does a good job. The proof that it does, according to Goldman, is that assets under management have grown ten-fold over the past decade, and now approach $600 billion. Its mutual-fund business, the only part that provides public, verifiable results, has expanded from $5 billion in 1996 to $37 billion now, according to Financial Research Corp, a Boston-based fund tracker. Typically, such growth is driven by performance, but Goldman's results, as evaluated by Morningstar, which analyses funds, are distinctly mediocre, with fees slightly above average, and the wide disparity of individual returns that is common among sales-oriented brokerage firms (which throw up all manner of offerings, hoping a few will stick). A hedge-fund tracking service says this is broadly true in what it sees as well, but—a crucial caveat—it does not see everything and Goldman, for regulatory reasons, can legitimately say it is prohibited from publicising its own results. A few of the bank's funds or investment partnerships might have done particularly well and explain why it has attracted so many assets. But it is also possible that Goldman's growth is a bit of Oz, a magical name obscuring something far more ordinary behind the curtain.

The same sort of issues arise in Goldman's equity research, a product that is often considered the public face of underwriting acuity. In an annual poll by *Institutional Investor*, Goldman ranks as mediocre. Many investors contend it is no more compelling than the research put out by any of the big banks and is not as good as that of more specialised firms, notably Bernstein. Company executives, however, who have privileged access to Goldman's analysts and bankers, say they have high regard for their research.

And, as is always with Goldman, there may be more behind the curtain. One management consultant recalls offering a chief executive a detailed analysis of a firm or industry. The consultant said that his firm could do a superb job in two months. The executive said he could call Goldman in the evening and get an excellent report the next morning. This kind of research is not available on its website.

All of which goes to what Goldman has long contended is its chief strength—its employees. The bank is an unusually selective institution. To get hired at Goldman requires surviving extraordinary vetting. The 200 or so business-school students who arrive every year begin by submitting a CV. A small fraction win interviews, a tiny fraction survive the first round, and another 10 rounds may follow. To encourage the widest pool, every senior manager takes part in recruiting, paying two visits to a top university, the definition of which has broadened from the best known to places with predominantly black students and overseas colleges. Candidates from unusual backgrounds or with unusual circumstances can receive extraordinary scrutiny. Suzanne Nora Johnson, a vice-chairman, was hired from a law firm after 150 interviews, which if not a record should be.

Hank's come hither

Once an offer is made, an intense seduction follows which, if acceptance is in doubt, can include a telephone call from Hank Paulson, Goldman's chief executive. Increasingly, other investment banks have copied the intensity of Goldman's efforts.

Once hired, the intensity may actually increase. Everyone at every investment bank works hard, but people at Goldman are reputed to work at least as hard, maybe harder. Intense loyalty and commitment are required. Internal voice mails are routinely sent out to vast groups of people with the expectation that all will be returned—fast. At Goldman, a request from another division asking for an insight, a contact or some other form of help is not to be ignored. To see a Goldman employee on the street is to witness someone listening to voice mails or pounding a BlackBerry, often to another Goldman employee. This is broadly true for a fair part of New York, but at Goldman the communication demands seem more extreme.

At the time of Goldman's share offering, there was deep concern that without the lure of partnership, the junior bankers would flee to more lucrative firms. Departures began even before the first trades in Goldman's shares settled and have continued ever since. Hedge funds and private-equity industries are seeded with precisely the kind of former Goldman employees that no firm could possibly want to lose—intense, energetic, and entrepreneurial, with strong client relationships.

However, the ebb of successful money managers from the bank's proprietary trading operations to hedge funds has often been accompanied by their decision to use Goldman as their broker, or to provide Goldman's clients with preferred access to their funds. Few of its leading employees have moved on to work for the other investment banks. To have Goldman on a CV is, often enough, to be in demand. A head-hunter says the first challenge is to convince someone from Goldman that anywhere else is not a step down.

And there has been no shortage of people who want to stick around. Goldman operates as a strict hierarchy, with a fair number of its 24,000 employees aspiring to be chosen as one of the 1,200 managing directors, who in turn aspire to be among the 300 “participating” managing directors, in essence

partners with a slice of the profits. The selection is not always fair, suffering from the usual politics and whatever other flaws that beset every company, but it is a potent managerial tool. Elevations occur every other year, with one due this autumn.

Less visible, in preparation for the process, are what essentially amount to demotions. The level of “participation” enjoyed by one of the top 300 may be thinned according to his contribution to profits. Often enough, someone important is quietly asked to leave. This is one of Mr Paulson's most critical roles. He apparently does it well enough that word rarely leaks out in the firm. Sometimes even the person being dismissed is unaware they are being forced out—there is a brief discussion about a more interesting future.

Typically, senior Goldman employees are on several charitable boards and, invariably, there is a lot of personal wealth to be invested, given away, or, after a lifetime in an office, spent on something grand. Goldman, says Mr Paulson, is a hard place to be hired, a hard place to be promoted and a hard place to stay. And if you want an explanation of how Goldman endures, that, perhaps, is the best explanation of all.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Japan's financial institutions

A first, gentle shake

Apr 27th 2006 | TOKYO
From The Economist print edition

What the return of normal monetary policy might mean for Japan's banks, consumer lenders and insurers—and for their customers

SOON, possibly this summer, the Bank of Japan (BoJ) will join the world's other leading central banks in raising interest rates. Many forecasters think that rates, zero since 1999 except for one brief (and disastrous) interlude, could be 0.5% by the end of the year and a giddy 1% some time in 2007. Some on the central bank's monetary-policy board even think that next year 2% may be needed, although others fear this would break Japan's recovering but still fragile economy.

Financial markets have already reacted more strongly than expected to the end of the BoJ's unprecedented five-year-long experiment with quantitative easing—spraying banks with free money in an effort to stop prices falling and hold down the yen. Ten-year government yields have shot up, flirting with the 2% mark for the first time in six years. The effects of this have also been felt abroad, as the unwinding of the “carry trade”—borrowing cheaply in Japan to lend at higher rates elsewhere—has unsettled currencies in vulnerable markets, such as New Zealand.

Largely overlooked, however, have been the implications of dearer money for Japan's financial institutions and their customers. This is curious, when you recall how closely intertwined the country's slump was with the rotten state of much of its financial industry. The immediate beneficiaries are likely to be banks, life insurers and brokers. However, for consumer lenders—the main channel for unsecured household borrowing—the outlook is less good. And many corporate borrowers have cause to be nervous too.

Start with the banks. Although their industry is still overcrowded and they lack clear plans for

finding fresh sources of profit, many of them have cleaned up their loan books, are increasing lending and are looking stronger than they have done for a decade. Short-term rates on deposits, the banks' main source of funds, are still close to zero. These tend to rise more slowly than medium-term market interest rates, such as the five-year government bond yield, to which lending rates are linked. The yield on that bond has already risen from 0.8% at the beginning of the year to just under 1.4%. Banks can therefore expect their interest margins to expand.

Japan's giant life insurers are also rejoicing after a ghastly decade. For years losses have oozed from their core businesses, because the guaranteed returns on their policies exceeded the ultra-low rates they earned by holding bonds. Now they are starting to receive more than they must pay. Granted, both they and the banks will see (unrealised) capital losses on their bond portfolios as yields rise, but they own equities too; and the rising stockmarket should more than make up the difference. Securities companies are another happy lot: though highly leveraged, and thus vulnerable to rising interest rates, they can make easy money through margin trading and bond trading.

The biggest loser will be the consumer-finance industry. It finances itself by issuing bonds or borrowing from banks, both of which will become pricier. Many firms in the second tier and below are already struggling in the face of cut-throat competition and rising operating costs.

Meanwhile, Japanese officialdom is making business harder still. Regulators have ordered Aiful, one of the biggest lenders, to halt operations for between three and 25 days next month, for being too aggressive in collecting debt. A recent ruling by the Supreme Court, that borrowers need not pay more than the lower of two official (and mutually inconsistent) caps on interest rates, has caused many lenders to cut their profit estimates for the year that ended on March 31st, as they tot up extraordinary losses from customers refusing to pay all their interest. And this month Kaoru Yosano, the financial-services minister, has proposed merging the two caps by dropping the higher one, 29.2%, to the level of the lower, 15-20%. The industry's big firms have been lobbying frantically against this idea; thousands of smaller ones, which could go bust, are more worried still.

Delicate cherry blossom

However, the health of all these institutions will depend ultimately on the well-being of their customers—and thus, to a degree, on that of the Japanese economy as a whole. Although most economists are (at last) cautiously optimistic, the BoJ will have to feel its way carefully out of its unique experiment in quantitative easing. The rise in medium- and long-term government-bond rates has already taken many by surprise and has led to howls of protest from politicians. Koyo Ozeki, an analyst at PIMCO Japan, says much will depend on the pace and extent of the BoJ's interest-rate rises. With growth still reliant on exports, the state of the American and Chinese economies will matter too.

For the banks in particular, the health of corporate Japan is especially important. In general, Japanese companies are looking hale. But plenty are not at all fit, especially those that have failed to streamline their businesses and reduce their debts.

A list of Japan's top 100 interest-bearing debtors, compiled by Nomura Financial and Economic Research Centre, is peppered with names that look vulnerable to higher interest rates. The struggle to make a profit and reduce debt is still being waged at some big companies, including Daiei, once the biggest supermarket chain, Japan Airlines, Sanyo Electric, Rakuten, the biggest internet shopping mall, and Softbank (though the last could be cushioned by its large holding of Yahoo Japan shares). Crowded, unprofitable industries such as construction, railway operators and leasing repeatedly crop up. If borrowers struggle their lenders will suffer too.

Smaller firms, which account for more than three-quarters of the economy, have ratios of debt to equity almost twice those of big companies and are thus more vulnerable to rising rates. Bankruptcies, having fallen for several years, are gently rising again, says Takakazu Nakamori of Teikoku Databank, a think-tank. Still, adds Mr Nakamori, the government has already poured out almost ¥40 trillion ($350 billion) to feed smaller firms. This should postpone the weeding-out of weaker companies for a year or two. No one can be sure what will happen then.

The biggest question, however, is how Japan will adapt to a new era of financial discipline, says Akio Mikuni, president of Mikuni and Co, a credit-rating agency. As interest rates rise, companies will have to think harder about their various projects and to work harder to service their loans. Banks will have to evaluate loans according to credit risk—not the Japanese way hitherto. As long as the central bank has been pouring money into the financial system, which has then been used to prop up zombie companies, this has not been a worry. These firms have in effect been paying negative interest on their loans, says Mr Mikuni, because they have had to repay only part of their debt, thanks to waivers from the banks.

A lack of financial discipline long predates quantitative easing. The government poured public money into banks, again pocketed by weak companies. Before that, for decades Japanese banks and borrowers lived under the delusion that property prices would rise for ever, leading banks to press loans on any company that could offer property as collateral. Now there will be no free money splashing around. This may finally bring proper evaluation of credit risk and the consolidation of crowded industries.

Real-estate investment trusts and specialised private-equity funds, which have been scrambling to buy property in swanky districts of big cities, such as Tokyo, Osaka and Nagoya, where prices are booming, also have lots of debt. These borrowers, not to mention hundreds of builders and developers, are at risk too. Their lenders, which have also invested in property, could take a beating.

The return of higher interest rates ought to be taken as another sign that Japan's economy is at last getting healthy again. How steadily it recovers depends to a large extent on whether its financial institutions and their customers borrow and lend sensibly. Rising rates will be a test of whether the lessons have been learnt.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

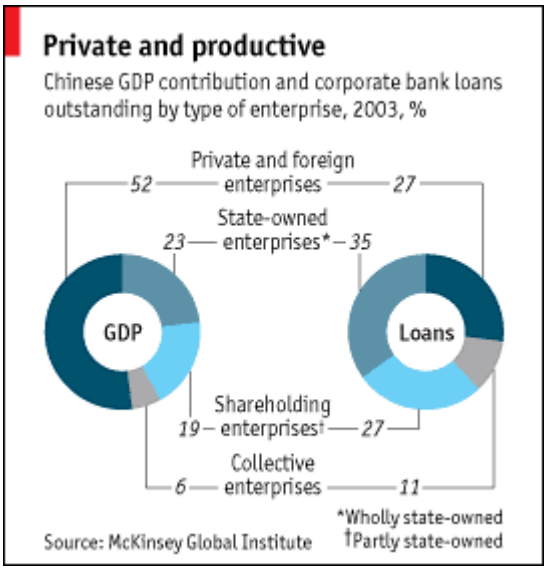
Chinese banks

Drag on the dragon

Apr 27th 2006 | HONG KONG
From The Economist print edition

If its banks worked, China could grow even faster

THE Chinese economy continues to astound. Behind its latest surge (see article) lies a renewed acceleration of bank lending. Credit growth at the mainland's financial institutions reached 15% in the year to March, just above the official target of 12-14%. Loan volumes are again nearing the levels of the 2003 credit boom, notes Jonathan Anderson, chief Asia economist at UBS. This week the authorities acted to stem the flood.



But China could sustain an even faster pace if its banks did their job properly. A mountain of bad debts is only the most visible sign of the persistent misallocation of capital. Many more loans do not go bad but yield only negligible returns. In a study* to be published on May 4th the McKinsey Global Institute, the consultancy's economics think-tank, calculates that China's GDP would be a staggering $320 billion, or 16%, higher if its lenders knew how to lend.

Around $60 billion, the think-tank reckons, could be gained from raising the banks' operating efficiency by cutting costs, putting in proper electronic payment systems, and developing bond and equity trading. The rest—some $260 billion—would come from redirecting loans to more productive parts of the economy. The banks should switch funds from poorly run state firms to private enterprises, which contribute 52% of GDP but account for only 27% of outstanding loans (see chart). This would both increase the efficiency of investment and raise returns for China's army of small savers.

Easier said than done. Aided by generous government bail-outs, the banks have worked to restructure themselves over the past several years. But changing old habits takes time: a recent paper by economists at the International Monetary Fund found little evidence that Chinese banks' lending decisions had become more commercial.

Even the industry regulator, which has been leading the reform effort, seems unwilling to break some taboos. Allowing foreign banks to take control of domestic rivals would undoubtedly help to introduce healthy competition and speed modernisation. Yet the long-running attempt of a consortium led by America's Citigroup to purchase 85% of Guangdong Development Bank (GDB), a relatively small institution, seems to have hit a brick wall. On April 25th Lai Xiaomin, director-general of the China Banking Regulatory Commission, said that he believed the “GDB case should not break the current rules”. These rules limit foreign investors to buying a total of 25% of a Chinese bank. No single investor is allowed more than 20%.

The poor state of the banks increases China's reliance on macroeconomic tools. The central bank raised interest rates surprisingly on April 27th, and announced guidelines to control banks' lending. It is expected to raise their reserve requirements next month, after China's spring holidays. Such top-down direction has served the economy fairly well in this cycle, averting the violent swings of earlier decades. Still, there is little doubt that this latest lending boom will produce another batch of bad debts and low-yielding loans. If the leaders in Beijing carried out the reforms needed to create a banking system that allocates capital properly, they would find the economy easier to steer—and their countrymen would be better off.

---

*"Putting China's Capital to Work: The Value of Financial System Reform."

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Listed funds

Cocktail hour

Apr 27th 2006
From The Economist print edition

Flotations of exotic funds may leave investors with a bitter taste

STOCKMARKETS are generous hosts. They almost always leave something potent for latecomers. Just as individual investors have plucked up the courage to return to equities, three years after the rally started, they face an array of new investment opportunities which could barely look more exotic if they came with a cocktail stick and umbrella.

Initial public offerings (IPOs) of pools of private-equity investments, eastern European property or the riskiest portions of mortgage-backed securities have gained in popularity recently, as have exchange-traded funds tracking the price of just about anything from gold to newly listed shares. Next week, Kohlberg Kravis Roberts (KKR), a grand name of private equity, will attempt to raise $1.5 billion through an IPO in Europe and a private placement in America. That is a most unusual step in a secretive industry, given the disclosure that listings require. Hedge funds, which also have a bat-like horror of daylight, are braving it nonetheless with plans to float pools of credit, such as tranches of collateralised debt obligations (CDOs).

Such investments will not be aimed specifically at retail investors. Mostly, they give institutional fund managers restricted to publicly quoted equities a chance to dabble in popular “alternative” assets that have performed well lately. In return, the stockmarkets give them far more liquidity.

But it would be no surprise were individuals also to buy them, especially if they continue to deliver high returns. Retail investors are great popularity chasers. As stockmarkets have rallied, they have flocked back into equities. In America that is reflected in the sharp share-price increases of online brokers such as Charles Schwab. In Europe net inflows into open-ended funds, or mutual funds, rose by almost 50% last year, according to the European Fund and Asset Management Association. In Britain alone, net sales of unit trusts to retail investors surged to £4.6 billion ($8.1 billion) in the first quarter (see chart). If that level of quarterly sales were to continue all year, it would eclipse the £17.7 billion peak in 2000, says the country's Investment Management Association (IMA). “These are investors chasing the market, rather than driving it,” says Richard Saunders, chief executive of the IMA.

Image Bank

But as they grasp at its tail, they are increasingly drawn to non-traditional investments, including emerging markets and property. IMA data show that the best-selling funds to retail investors in the first quarter specialised in property. That helps explain a burst of listings this month on London's Alternative Investment Market for funds backing property ventures in places as far apart as India and Croatia.

Similarly, bankers expect ordinary investors to be drawn

to private equity, because of the huge returns that buy-out funds have generated and their rarity. KKR's European listing is partially aimed at those without the $25m needed to join one of its limited partnerships.

But the broad range of investors who can buy these new funds raises two important questions. Will people understand what's driving the returns? And are the funds being foisted on an unsuspecting public because the smart money realises the underlying markets will soon peak?

In KKR's case, the answers are probably comforting. Although the private-equity market is a bit frothy, with too many funds chasing deals and pushing up bid premiums, it expects to raise up to $15 billion in private money soon, which would be a huge endorsement. It will also give shareholders quarterly performance updates, which its limited partners don't get.

The pros and cons of listing structured debt funds are less clear-cut. Craig Coben, an equity-markets banker at Merrill Lynch, argues that they are directed chiefly at equity portfolio managers who want a share of double-digit returns in asset-backed markets, such as CDOs, sometimes boosted by leverage. “They're giving you access to investments you otherwise wouldn't have,” he says.

How well understood they are is a different matter. This month Washington Square, a niche asset manager, listed Carador, the first CDO fund on the London Stock Exchange. It is expected to invest mostly in some of the riskiest bits of CDOs, known as equity tranches, which are not easy to value. The chances are, its managers are well qualified to do so. But less clever funds may well follow. And then it will be time for retail investors to pile in.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Earnings guidance

The sound of silence

Apr 27th 2006 | NEW YORK
From The Economist print edition

More companies are keeping mum about future profits

EARNINGS season is in full swing in America and this time there may be more surprises than usual. A growing number of companies have stopped providing quarterly "earnings guidance"—the practice of saying publicly what they expect their profits to be. These include General Motors and Ford, which announced big first-quarter losses on April 20th and 21st respectively. Both car giants said it would be some time before they resumed giving guidance to Wall Street.

The guidance habit became increasingly popular in the late 1990s after Congress passed legislation shielding companies from legal liability for forecasts of performance. According to McKinsey, a consultancy, the number of firms telling the market what to expect rose from 92 in 1994 to about 1,200 by 2001. Now a small but growing group, including Coca-Cola, AT&T, McDonald's and Google, floated in 2004, is heading the opposite way. A survey published this month by the National Investor Relations Institute, a professional association, found that the share of companies giving guidance has dropped from 71% in 2005 to 66% this year.

Getty Images

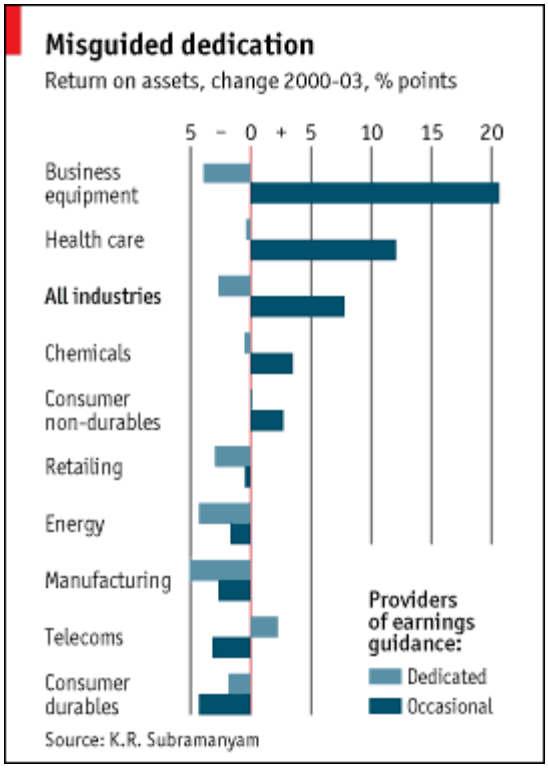
An alternative forecasting method

Behind this trend is the belief that quarterly guidance, coupled with a fixation on whether companies match their forecast earnings per share (EPS) to the last penny, does more harm than good. Critics of the practice, who include not only company bosses but also regulators, academics and investors (among them, Warren Buffett), think companies are pushed into making poor decisions or tinkering with numbers to make sure that they hit their short-term targets. Some research analysts are also disgruntled. Candace Browning, head of global research at Merrill Lynch, told a congressional committee earlier this month: "This process drowns out investor debate and distils what should be a complex message about performance into a single number—dictated by the company itself."

Research by K.R. Subramanyam and Mei Cheng, of the University of Southern California, and Yuan Zhang, of Columbia University, backs the critics up. The trio analysed the behaviour of nearly 1,000 companies, which they tagged as either "occasional" or "dedicated" guiders, between 2001 and 2003. They used research and development (R&D) spending as a proxy for "myopic" behaviour, because slashing R&D boosts income now at the expense of later growth. The researchers found that dedicated guiders invested less in R&D and met or beat analysts' EPS estimates more often than occasional guiders did. In the long run, the earnings of dedicated guiders grew more slowly than those of companies that gave a steer less often (see chart).

However, guidance has its defenders. They argue that

more information is always better—and that guidance has become more important since the passing of "Regulation FD" in 2000. This rule compels firms to disclose information either to everyone or to no one, so that they cannot give a head start to favoured investors or analysts. This leaves earnings guidance as one of the few legal ways in which bosses can air their views on future performance.



Proponents of earnings guidance also say that it benefits the capital markets by reducing uncertainty and therefore, in theory, companies' cost of capital. Some research analysts say that, at least in the short run, Wall Street forecasts for companies that stop giving guidance are all over the map, leading to more earnings "surprises" and greater share-price volatility.

Others fear that ending guidance can be a fig leaf for companies in trouble. In a recent study Shuping Chen, Dawn Matsumoto and Shiva Rajgopal, of the University of Washington, analysed 76 companies that have ended quarterly earnings guidance since 2000 (some stopped altogether, some moved to an annual basis). The researchers found that poor performers were more likely to reduce guidance.

In any case, say critics of the trend, pressures to meet short-term goals will persist for as long as companies release short-term figures. Enron, for instance, twisted its figures to show consistent quarterly growth to Wall Street—not because it provided guidance. Incentive schemes that reward such "consistent" growth are a better target for corporate reformers than limiting information to the market, they say.

One welcome effect of the trend is that many of the companies that eschew quarterly earnings guidance are releasing, instead, more information on long-term trends and other financial measures. Mr Buffett's Berkshire Hathaway provides useful annual notes on the state of the company and on how its investments have done. IAC/InterActiveCorp, a media, retailing and online-business group, supplies information on its annual budget. Ultimately, it is data like these that help the markets—not the false precision of the next quarter's EPS.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The economics of smoking

Filtering the evidence

Apr 27th 2006
From The Economist print edition

Why do Europeans smoke more than Americans?

JUDGED by their waistlines, Europeans are much healthier than Americans. More than 30% of Americans are obese, compared with 13% of Germans and under 10% of the French. But judged by their lungs, Americans are fitter than their peers across the Atlantic. Only 19% of adult Americans smoke, against 34% of Germans and 27% of Britons. Why do Europeans light up so much more?

David Cutler and Edward Glaeser, of Harvard University, attempt to answer this question in a recent paper*. Since they are both economists, the first thing they look at is price. Perhaps smoking is more expensive in America? Not so. Relative to other commodities, cigarettes are in fact 37% cheaper in America than they are in the European Union. You can buy a pack for $3.60 on average stateside, but you have to pay $6.25 in Britain. The French add $2.06 in tax per packet, the Americans only 86 cents.

AFP

High-tar diet

The second explanation an economist will look for is income. Smoking rises then falls with affluence. The very poor cannot afford to smoke as much as they might like. The rich, on the other hand, don't like to smoke as much as they could, because they put a higher value on a long and healthy life. This might explain why so many more Turks (about half of them) than Americans smoke, but it can cover only about a quarter of the gap between Americans and western Europeans.

In fact, the gap is best explained by neither prices nor incomes, but by ignorance. Europeans are less likely than Americans to believe that smoking is harmful. Only 73% of Germans, for example, believe smoking is dangerous, against 91% of Americans.

The two authors conjecture that beliefs are the result of smokers' habits, not the cause of them. A person who enjoys his cigarettes has an incentive to persuade himself that they will not do him much harm. But even non-smokers in Europe are less likely than their American counterparts to believe the weed is dangerous. These differences in beliefs may account for 20-40% of the transatlantic gap, the two authors argue.

What accounts for the rest of it? Vanity is one factor the two economists do not investigate. Since smoking suppresses appetite, perhaps those svelte European waistlines are bought at the expense

of their unhealthy lungs.

---

*"Why do Europeans smoke more than Americans?" NBER Working Paper, no.12124. Available at www.nber.org/papers/w12124

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economics focus

A host of problems

Apr 27th 2006
From The Economist print edition

Would a second Plaza agreement make sense?

Get article background

IF YOU want to guarantee an invitation to a high-powered summit, your best bet is to host it yourself. The International Monetary Fund was not invited to New York's Plaza Hotel in September 1985, when the finance ministers of America, Japan, West Germany, France and Britain agreed to bring the dollar down. Nor was it officially represented at the Louvre Palace in Paris 17 months later, when the same powers called a halt to the greenback's fall. As America's current-account deficit has resurged in recent years, the IMF has remained on the sidelines of the great dollar debate. But at its spring meetings last weekend, the fund got a foot in the door. It will serve as a kind of "master of ceremonies" should today's economic powers ever again seek a co-ordinated response to a great global question.

The IMF was given two duties. It will devote more effort to "multilateral surveillance", scrutinising how each member's policies affect everyone else. This wide-angle focus on spillovers from one country to the next differs from the fund's customary approach, wherein it takes individual mugshots of each of its members' economies in turn. Once it has identified matters of collective concern, the fund will then get the parties together to look for collective solutions.

The guest lists for these meetings will be quite a bit longer than the cosy handful invited to the Plaza or the Louvre. A growing number of economies can now lay some claim to global significance. For the past few years, China has been the ghost at the feast whenever the older economic powers break bread together. Now the big oil-exporters are equally difficult to ignore. On April 21st the fund held an informal chin-wag on global imbalances with finance ministers from more than 20 countries. By the time it next meets in Singapore in September, its managing director, Rodrigo de Rato, will make concrete proposals to give several emerging economies—such as China, South Korea, Turkey and Mexico—more votes on the IMF's board, in recognition of their growing clout.

Were the fund to convene a summit on global imbalances, what might the guests talk about? In the original Plaza agreement, America promised to curb its budget deficit, the countries with big trade surpluses—Germany and Japan—agreed to expand domestic demand, and all conspired to sell dollars in the foreign-exchange markets. Several economists at the Institute for International Economics (IIE), a think-tank in Washington, DC, believe that a similar bargain should be struck today.

The case for a second Plaza agreement rests on game theory as much as macroeconomics. What is rational for each country acting unilaterally might not be best were all to act in concert. In a recent paper William Cline of the IIE* argues that the countries of emerging Asia in particular are trapped in a prisoner's dilemma. They are afraid of floating freely against the dollar because they

want to remain competitive against each other, as well as against America. As a result, no single country will let its currency strengthen much, unless they all rise together. If Mr Cline had his way, China's yuan would appreciate by more than 40% against the dollar in real terms—a huge jump. But if the currencies of all China's trading partners were to strengthen against the greenback at the same time, the yuan's trade-weighted value would increase by little more than 8%, he says.

If the dollar were to fall, America's overspending government would have to make way, Mr Cline argues. A cheaper dollar would boost demand for America's exports. To stop this extra demand from stoking inflation, America's government would need to tighten its own belt, much as it promised to do in 1985. This, says Mr Cline, opens up a second opportunity for international co-operation. If the American government taxed more or spent less, other countries would need to spend more to maintain global demand. America's Treasury is fond of pointing out how reliant the rest of the world is on American profligacy. And this month Mr de Rato warned those pointing a finger at America's red ink to “be careful what you wish for”.

Blood in the foyer

Not everyone recalls the Plaza agreement as fondly as Mr Cline does. For Ronald McKinnon, of Stanford University, the deal exemplified not amicable co-operation but Japanese capitulation†. The country's policymakers let the yen strengthen to appease Japan-bashers in Congress, who were outraged by America's bilateral trade deficit. The yen jumped in fits and starts from about 250 to the dollar in 1985 to a peak of 80 ten years later. Mr McKinnon blames the strong yen for the liquidity trap that ensnared Japan in the 1990s. He fears that what befell Japan in those days could also happen to China were it to succumb to similar American harassment.

The Plaza Hotel closed last year. Many of its rooms are being converted into flats. The IMF may find that the political fashions that made the Plaza agreement possible are also a thing of the past. The Americans are quite receptive to the fund's new role, but largely because they think the fund will do some of their China-bashing for them. America's Treasury has explicitly rejected the idea of current-account targets of the sort envisaged by Mr Cline, and it is hardly going to raise taxes just because the IMF asks it to. This week the Chinese, less pliant than the Japanese of yesteryear, were also keen to point out that it was not the fund's job to tell them what value the yuan should be—not that the fund could answer that question even if it wanted to. The fund should make the most of its role as master of ceremonies, but it will never be the master of currencies.

---

*“The Case for a New Plaza Agreement”, IIE Policy Briefs, December 2005

†“China's New Exchange Rate Policy: Will China Follow Japan into a Liquidity Trap?”

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Medical marijuana

Reefer madness

Apr 27th 2006
From The Economist print edition

Marijuana is medically useful, whether politicians like it or not

Getty Images

IF CANNABIS were unknown, and bioprospectors were suddenly to find it in some remote mountain crevice, its discovery would no doubt be hailed as a medical breakthrough. Scientists would praise its potential for treating everything from pain to cancer, and marvel at its rich pharmacopoeia—many of whose chemicals mimic vital molecules in the human body. In reality, cannabis has been with humanity for thousands of years and is considered by many governments (notably America's) to be a dangerous drug without utility. Any suggestion that the plant might be medically useful is politically controversial, whatever the science says. It is in this context that, on April 20th, America's Food and Drug Administration (FDA) issued a statement saying that smoked marijuana has no accepted medical use in treatment in the United States.

The statement is curious in a number of ways. For one thing, it overlooks a report made in 1999 by the Institute of Medicine (IOM), part of the National Academy of Sciences, which came to a different conclusion. John Benson, a professor of medicine at the University of Nebraska who co-chaired the committee that drew up the report, found some sound scientific information that supports the medical use of marijuana for certain patients for short periods—even for smoked marijuana.

This is important, because one of the objections to marijuana is that, when burned, its smoke contains many of the harmful things found in tobacco smoke, such as carcinogenic tar, cyanide and carbon monoxide. Yet the IOM report supports what some patients suffering from multiple sclerosis, AIDS and cancer—and their doctors—have known for a long time. This is that the drug

gives them medicinal benefits over and above the medications they are already receiving, and despite the fact that the smoke has risks. That is probably why several studies show that many doctors recommend smoking cannabis to their patients, even though they are unable to prescribe it. Patients then turn to the black market for their supply.

Another reason the FDA statement is odd is that it seems to lack common sense. Cannabis has been used as a medicinal plant for millennia. In fact, the American government actually supplied cannabis as a medicine for some time, before the scheme was shut down in the early 1990s. Today, cannabis is used all over the world, despite its illegality, to relieve pain and anxiety, to aid sleep, and to prevent seizures and muscle spasms. For example, two of its long-advocated benefits are that it suppresses vomiting and enhances appetite—qualities that AIDS patients and those on anti-cancer chemotherapy find useful. So useful, in fact, that the FDA has licensed a drug called Marinol, a synthetic version of one of the active ingredients of marijuana—delta-9-tetrahydrocannabinol (THC). Unfortunately, many users of Marinol complain that it gets them high (which isn't what they actually want) and is not nearly as effective, nor cheap, as the real weed itself.

This may be because Marinol is ingested into the stomach, meaning that it is metabolised before being absorbed. Or it may be because the medicinal benefits of cannabis come from the synergistic effect of the multiplicity of chemicals it contains.

Just what have you been smoking?

THC is the best known active ingredient of cannabis, but by no means the only one. At the last count, marijuana was known to contain nearly 70 different cannabinoids, as THC and its cousins are collectively known. These chemicals activate receptor molecules in the human body, particularly the cannabinoid receptors on the surfaces of some nerve cells in the brain, and stimulate changes in biochemical activity. But the details often remain vague—in particular, the details of which molecules are having which clinical effects.

More clinical research would help. In particular, the breeding of different varieties of cannabis, with different mixtures of cannabinoids, would enable researchers to find out whether one variety works better for, say, multiple sclerosis-related spasticity while another works for AIDS-related nerve pain. However, in the United States, this kind of work has been inhibited by marijuana's illegality and the unwillingness of the Drug Enforcement Administration (DEA) to license researchers to grow it for research.

Since 2001, for example, Lyle Craker, a researcher at the University of Massachusetts, has been trying to obtain a licence from the DEA to grow cannabis for use in clinical research. After years of prevarication, and pressure on the DEA to make a decision, Dr Craker's application was turned down in 2004. Today, the saga continues and a DEA judge (who presides over a quasi-judicial process within the agency) is hearing an appeal, which could come to a close this summer. Dr Craker says that his situation is like that described in Joseph Heller's novel, “Catch 22”. “We can say that this has no medical benefit because no tests have been done, and then we refuse to let you do any tests. The US has gotten into a bind, it has made cannabis out to be such a villain that people blindly say ‘no’.”

Anjuli Verma, the advocacy director of the American Civil Liberties Union (ACLU), a group helping Dr Craker fight his appeal, says that even if the DEA judge rules in their favour, the agency's chief administrator can still decide whether to allow the application. And, as she points out, the DEA is a political organisation charged with enforcing the drug laws. So, she says, the ACLU is in this for the long haul, and is already prepared for another appeal—one that would be heard in a federal court in the normal judicial system.

Ms Verma's view of the FDA's statement is that other arms of government are putting pressure on the agency to make a public pronouncement that conforms with drug ideology as promulgated by the White House, the DEA and a number of vocal anti-cannabis congressmen. In particular, the federal government has been rattled in recent years by the fact that eleven states have passed laws allowing the medical use of marijuana. In this context it is notable that the FDA's statement emphasises that it is smoked marijuana which has not gone through the process necessary to make it a prescription drug. (Nor would it be likely to, with all of the harmful things in the smoke.) The statement's emphasis on smoked marijuana is important because it leaves the door open for the agency to approve other methods of delivery.

High hopes

Donald Abrams, a professor of clinical medicine at the University of California, San Francisco, has been working on one such option. He is allowed by the National Institute on Drug Abuse (the only legal supplier of cannabis in the United States) to do research on a German nebuliser that heats cannabis to the point of vaporisation, where it releases its cannabinoids without any of the smoke of a spliff, and with fewer carcinogens.

That is encouraging. But it does not address the wider question of which cannabinoids are doing what. For that, researchers need to be able to do their own plant-breeding programmes.

In America, this is impossible. But it is happening in other countries. In 1997, for example, the British government asked Geoffrey Guy, the executive chairman and founder of GW Pharmaceuticals, to come up with a programme to develop cannabis into a pharmaceutical product.

In the intervening years, GW has assembled a “library” of more than 300 varieties of cannabis, and obtained plant-breeder's rights on between 30 and 40 of these. It has found the genes that control cannabinoid production and can specify within strict limits the seven or eight cannabinoids it is most interested in. And it knows how to crossbreed its strains to get the mixtures it wants.

Nor is this knowledge merely academic. Last year, GW gained approval in Canada for the use of its first drug, Sativex, which is an extract of cannabis sprayed under the tongue that is designed for the relief of neuropathic pain in multiple sclerosis. Sativex is also available to a more limited degree in Spain and Britain, and is in clinical trials for other uses, such as relieving the pain of rheumatoid arthritis.

At the start of this year, the company made the first step towards gaining regulatory approval for Sativex in America when the FDA accepted it as a legitimate candidate for clinical trials. But there is still a long way to go.

And that delay raises an important point. Once available, a well-formulated and scientifically tested drug should knock a herbal medicine into a cocked hat. No one would argue for chewing willow bark when aspirin is available. But, in the meantime, there is unmet medical need that, as the IOM report pointed out, could easily and cheaply be met—if the American government cared more about suffering and less about posturing.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Particle physics

The collider calamity

Apr 27th 2006
From The Economist print edition

A report on the state of fundamental physics in America

NEAR Waxahachie in Texas, there is a hole in the ground. Not just any old hole. This one is almost 23km long and curves in what would be, if it were extended, a circular loop. It is the site of what was intended to be the world's biggest and best particle accelerator, a machine capable of unlocking some of the fundamental secrets of nature itself. Ever since the project to build it was cancelled in 1993, after nearly $2 billion had been spent on construction, America's lead in particle physics has been shrinking. This week, a report by the country's National Research Council (NRC) outlined what America can do to regain its pre-eminence.

The outlook is grim. After decades of making discoveries about the fundamental building blocks of nature, America's particle-physics colliders are to close. The Tevatron at Fermilab, near Chicago, is the world's highest-energy particle-smasher. But that honour will be wrenched from it next year, when the Large Hadron Collider (LHC) opens for business at CERN, the European particle-physics laboratory near Geneva. The Tevatron is scheduled to shut by the end of the decade, and the LHC is expected to dominate international particle physics for the next 15 years.

America's other accelerators are in trouble, too. Work at the Stanford Linear Accelerator Centre is moving away from particle physics and into generating high-energy X-rays. Funding for the Relativistic Heavy Ion Collider at the Brookhaven National Laboratory is so tight that the machine managed to keep running only after a philanthropist intervened. Many American particle physicists have switched their attentions to the LHC. And while physicists dream of shiny new machines, none is scheduled to be built in America. In the review of its top ten research advances of 2005, *Science* singled out American particle physics for the booby prize.

This is a shame. While particle physics does not produce economic returns in the lifetimes of the administrations that fund the experiments, it is a fascinating endeavour. Over the past 100 years, physicists have succeeded in identifying the fundamental building blocks of the universe, both in terms of matter and of the forces that act on it. Yet the so-called Standard Model of particle physics, which weaves these discoveries together, and which has proved so successful to date, is incomplete. If physicists are to improve on it, they need machines that supply particles at higher energies to probe the nature of space and time. Such machines could provide answers about how the universe began and how it will evolve.

In this light, the NRC report makes interesting if somewhat biased reading. It wants America to retake the lead in particle physics, and to host the next new particle accelerator to be built after the LHC. A decision on whether to build this machine, dubbed the International Linear Collider, will not be taken until the initial results from the LHC are known. If these point to more fundamental physics beyond the Standard Model, as is widely expected, then there would be mileage in building a more powerful accelerator to study these phenomena. Such a decision would not be made until 2010, but America's physicists are keen for their country to host such a facility.

To do so, the NRC reckons, America will need to spend between 2% and 3% more each year in real terms on particle physics. That might not sound onerous, but it amounts to $500m over the next five years.

European particle physicists are also keen to lead the world. A similar panel of experts is close to finalising a European strategy. The CERN Council Strategy Group, as it is called, will meet near Berlin next week to hammer out a consensus. Then, in July, this consensus will be presented to the politicians who decide the funding of particle physics.

At present, Europe is poised to take the lead: it will soon have the world's biggest and best particle accelerator. Whether CERN could afford to host the International Linear Collider, though, is a moot point. The laboratory has had to take out loans to build the LHC, and it is likely that any future money would be spent on upgrading that machine.

Then there is Japan, which has a promising programme in neutrino physics, another area where the report urges America to push forwards. Japan recently lost the fight to host the International Thermonuclear Experimental Reactor, an expensive international project which aims to demonstrate that nuclear fusion could produce power on a commercial basis, so it feels it is owed something. And, depending on the strengths of their economies when the time comes to make the decision, Russia, China and India could all be interested, too.

In any event, American particle physics looks set for a period in the wilderness. Whether the country can recapture its superiority after such a spell depends on whether there is the political will to pour more money into holes in the ground.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Particle physics

The collider calamity

Apr 27th 2006
From The Economist print edition

A report on the state of fundamental physics in America

NEAR Waxahachie in Texas, there is a hole in the ground. Not just any old hole. This one is almost 23km long and curves in what would be, if it were extended, a circular loop. It is the site of what was intended to be the world's biggest and best particle accelerator, a machine capable of unlocking some of the fundamental secrets of nature itself. Ever since the project to build it was cancelled in 1993, after nearly $2 billion had been spent on construction, America's lead in particle physics has been shrinking. This week, a report by the country's National Research Council (NRC) outlined what America can do to regain its pre-eminence.

The outlook is grim. After decades of making discoveries about the fundamental building blocks of nature, America's particle-physics colliders are to close. The Tevatron at Fermilab, near Chicago, is the world's highest-energy particle-smasher. But that honour will be wrenched from it next year, when the Large Hadron Collider (LHC) opens for business at CERN, the European particle-physics laboratory near Geneva. The Tevatron is scheduled to shut by the end of the decade, and the LHC is expected to dominate international particle physics for the next 15 years.

America's other accelerators are in trouble, too. Work at the Stanford Linear Accelerator Centre is moving away from particle physics and into generating high-energy X-rays. Funding for the Relativistic Heavy Ion Collider at the Brookhaven National Laboratory is so tight that the machine managed to keep running only after a philanthropist intervened. Many American particle physicists have switched their attentions to the LHC. And while physicists dream of shiny new machines, none is scheduled to be built in America. In the review of its top ten research advances of 2005, *Science* singled out American particle physics for the booby prize.

This is a shame. While particle physics does not produce economic returns in the lifetimes of the administrations that fund the experiments, it is a fascinating endeavour. Over the past 100 years, physicists have succeeded in identifying the fundamental building blocks of the universe, both in terms of matter and of the forces that act on it. Yet the so-called Standard Model of particle physics, which weaves these discoveries together, and which has proved so successful to date, is incomplete. If physicists are to improve on it, they need machines that supply particles at higher energies to probe the nature of space and time. Such machines could provide answers about how the universe began and how it will evolve.

In this light, the NRC report makes interesting if somewhat biased reading. It wants America to retake the lead in particle physics, and to host the next new particle accelerator to be built after the LHC. A decision on whether to build this machine, dubbed the International Linear Collider, will not be taken until the initial results from the LHC are known. If these point to more fundamental physics beyond the Standard Model, as is widely expected, then there would be mileage in building a more powerful accelerator to study these phenomena. Such a decision would not be made until 2010, but America's physicists are keen for their country to host such a facility.

To do so, the NRC reckons, America will need to spend between 2% and 3% more each year in real terms on particle physics. That might not sound onerous, but it amounts to $500m over the next five years.

European particle physicists are also keen to lead the world. A similar panel of experts is close to finalising a European strategy. The CERN Council Strategy Group, as it is called, will meet near Berlin next week to hammer out a consensus. Then, in July, this consensus will be presented to the politicians who decide the funding of particle physics.

At present, Europe is poised to take the lead: it will soon have the world's biggest and best particle accelerator. Whether CERN could afford to host the International Linear Collider, though, is a moot point. The laboratory has had to take out loans to build the LHC, and it is likely that any future money would be spent on upgrading that machine.

Then there is Japan, which has a promising programme in neutrino physics, another area where the report urges America to push forwards. Japan recently lost the fight to host the International Thermonuclear Experimental Reactor, an expensive international project which aims to demonstrate that nuclear fusion could produce power on a commercial basis, so it feels it is owed something. And, depending on the strengths of their economies when the time comes to make the decision, Russia, China and India could all be interested, too.

In any event, American particle physics looks set for a period in the wilderness. Whether the country can recapture its superiority after such a spell depends on whether there is the political will to pour more money into holes in the ground.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

AIDS

Bitter fruit

Apr 27th 2006
From The Economist print edition

Another idea for stopping AIDS falls flat

Get article background

LIME juice is famous in medical history. Sailors—particularly British sailors—drank it to keep scurvy at bay. But the past few years have seen another use mooted. This is that, if applied to the vagina, it might protect a woman from HIV infection, and thus from AIDS. On April 24th a group of researchers met at the Microbicides 2006 conference in Cape Town to discuss the matter.

Though a lime-juice douche sounds a ghastly idea, women have been putting acids into their vaginas for millennia, in the hope of preventing pregnancy and sexually transmitted diseases. Indeed, cleaning with lime juice is common practice in parts of Africa. Of 200 prostitutes surveyed in 2004 in the Nigerian city of Jos, 163 said they rinsed with lemon or lime juice before or after sex to prevent pregnancy and infections. The question is, are they sensible to do so?

Acids immobilise sperm and kill pathogens, including HIV. (Laboratory studies have shown that a one-in-five dilution of lemon or lime juice inactivated 90% of HIV in just two minutes.) And, in addition to its high citric-acid content, lime juice has a second attractive feature: it literally grows on trees.

However, there is also the matter of the damage that citric acid causes to the vaginal lining. Two studies, one carried out by Carol Lackman-Smith of the Southern Research Institute in Frederick, Maryland, and the other by Christine Mauck of CONRAD (an American contraceptive research and development programme), have shown that anything more concentrated than a one-to-one dilution of lemon juice would damage the cells that line the vagina. Such damage would make it easier, rather than harder, for HIV to get into the bloodstream.

Given the success in the laboratory of a one-in-five dilution, that does not sound an insuperable objection. But there is a second problem. In the bedroom, seminal fluid is also involved in the mix. And seminal fluid is alkaline. The need to overcome this alkalinity means it takes at least a 50% solution of lime juice to inactivate the virus during real sexual intercourse. The upshot is that, as a microbicide, lime juice is safe when it is ineffective, and effective when it is unsafe. Which leaves the small matter of the women in Jos, and the many others who use similar methods. They need to be told that in seeking protection, they may, in fact, be putting themselves at greater risk.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Growth and its consequences

The perils of prosperity

Apr 27th 2006
From The Economist print edition

Can you be too rich?

Alamy

The Challenge of Affluence: Self-Control and Well-Being in the United States and Britain Since 1950
By Avner Offer

Oxford University Press; 454 pages; $45 and £30

Buy it at
Amazon.com
Amazon.co.uk

MIDWAY through the first decade of the 21st century, economic growth is pulling millions out of poverty. Growth, so devoutly desired yet often so elusive for developing countries, is occurring in China and India on an heroic scale. Yet once affluence is achieved, its value is often questioned. In the 1960s and 1970s, economists started worrying about environmental and social limits to growth. Now Avner Offer, professor of economic history at Oxford University, has added a weighty new critique to this tradition.

“The Challenge of Affluence” accepts that the populations of poor countries gain from growth, but says that the main benefits of prosperity are achieved at quite modest levels. Its central thesis is that rising living standards in Britain and America have engendered impatience, which undermines well-being. The fruits of affluence are bitter ones, and include addiction, obesity, family breakdown and mental disorders.

The claim is as ambitious as it is pessimistic. Professor Offer, who has an unorthodox academic background (before embarking on his academic career he worked as a soldier, farmer and conservation worker in his native Israel), is unafraid to challenge economic orthodoxy. He gives short shrift to the rational decision-makers of economic models, arguing that consumers are myopic creatures easily tempted by the lures of immediate satisfaction. As societies become wealthier, traditions and institutions that bolster commitment and far-sighted behaviour are eroded. Individuals increasingly live for today rather than tomorrow. Prudence may have built up

affluence, but affluence is no friend of prudence.

Professor Offer buttresses his theoretical challenge with a large casebook from America and Britain. Drug addiction, which “shows how choice is fallible”, is widespread. Obesity rates have risen alarmingly, in large measure because of the availability of fast food. The swift adoption of television in American homes after the second world war is contrasted with the slower spread of appliances like dishwashers. This, he says, shows consumers' preference for time-using devices of “sensual arousal” over time-saving investments around the home. Falling saving rates, rising divorce figures and much else besides are yoked to the argument.

The book fails to convince, however, both in its challenge to mainstream economics and in its interpretation of the historical evidence. Choices may multiply with the growth of affluence, but there is nothing new in the tension between impatience and prudence. Behavioural economics is now helping to explain the common tendency to procrastinate over decisions such as joining retirement-saving plans that would be in individuals' long-term interest. However, this body of work is best understood as a set of exceptions that modifies but leaves intact the canonical model of rational choice, not least since it is irrational to suppose that people in general behave irrationally.

Furthermore, there is little reason to believe—and scant evidence to support—the notion that behaviour becomes more myopic as societies get richer. Rather, individuals face new and difficult challenges that they succeed, by and large, in meeting. One example is rising enrolment in higher education. By choosing to study rather than to work, students are sacrificing short-term income and greater consumption in order to secure higher living standards in the future.

Another example of far-sighted behaviour and self-control is the investment that people make in their own health by adopting new lifestyles. Despite the addictiveness of nicotine, the prevalence of smoking has plunged as consumers have become better informed about its risks. Individuals are also investing in their health through more exercise and better diet. Fast-food chains have stumbled as more and more consumers reject unhealthy meals. Obesity rates among American women have stabilised, an early sign of a turning-point in the great fattening of society.

Many of Professor Offer's historical exhibits can readily be unyoked from his thesis. A more plausible explanation of the rapid spread of television is that it became a cultural and social necessity, binding nations together in the immediacy of news and in shared entertainment. Household-saving rates may have fallen, but this does not necessarily indicate imprudence since it has occurred at a time of steep rises in housing wealth. Reluctance to save for retirement may be quite rational if, as in Britain, prudence is quite likely to mean a loss of means-tested pension benefits. The upsurge of divorce in the 1970s was caused by new social mores and legislative changes rather than affluence. As the author himself points out, easier divorce alleviated a great deal of misery: female suicide rates and domestic violence fell.

That said, Professor Offer presents some fascinating case-studies and makes some sensible points. It could be argued, for example, that public policy in already affluent economies should be focused on rectifying specific social maladies, such as mental illness, rather than striving to raise growth. For one thing, it is very difficult to influence the long-run growth rate. More importantly, the harm experienced by the mentally ill and those around them is so great that remedies deserve priority. And rich societies are better able to foot the bill for treatment and medical advances.

However, Professor Offer's broader message of gloom and foreboding is unwarranted. Measures indicating that well-being stalls beyond a certain modest level of affluence take no account of rising expectations, which are a virtue in themselves. Not only is prosperity welcome in itself but it contributes to rising life expectancy, another extraordinary boon, not least because prosperity brings with it improved health care. Equally important, it extends horizons and widens

opportunities for more and more people. Affluence may present new challenges but they are a lot better than the alternative.

The Challenge of Affluence: Self-Control and Well-Being in the United States and Britain Since 1950.
By Avner Offer.
Oxford University Press; 454 pages; $45 and £30

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The internet

Terror.com

Apr 27th 2006
From The Economist print edition

“THE more websites, the better it is for us. We must make the internet our tool.” This could be a message from a chief executive urging his company to embrace the internet. In fact, these words appeared on a website used by jihadists and al-Qaeda for propagating violent anti-American propaganda.

Terror on the Internet: The New Arena, the New Challenges
By Gabriel Weimann

United States Institute of Peace Press; 309 pages; $24.95

Buy it at
Amazon.com
Amazon.co.uk

As Gabriel Weimann, a professor at Haifa University, demonstrates in this book, the internet has become a tool of vital importance to terrorists around the world. His eight-year survey of terrorists' use of the internet found that the 40 organisations designated as active terrorist groups by America's State Department now maintain more than 4,300 websites.

The attractions of the internet to terrorists are obvious; it allows for cheap, anonymous, international co-ordination. More important, it enables terrorists to bypass the mass media and deliver propaganda directly. Modern terrorists, Mr Weimann notes, “are not necessarily interested in the death or injury of their direct victims as much as in the impact of this psychological victimisation on a wider public”. Terrorism is not just violence, but violence with a message. And the internet allows terrorists to deliver that message directly to the public in the form of text, such as statements from suicide bombers, or images and videos including gruesome footage of beheadings.

A terrorist group's various websites may be aimed at its supporters, at the population it purports to serve, at its enemies, or at wider public opinion. Many terrorist sites, Mr Weimann notes, resemble corporate websites, complete with mission statements, press releases and historical background material. Some even sell mugs, T-shirts, badges and other merchandise. Just as the website of a failing company will abound with euphemisms to hide the fact, some terrorist websites play down or omit direct references to violence, though others are highly explicit.

Aside from communication—both with each other and with the public—terrorists use the internet to solicit money, recruit new supporters, distribute training and weapons-making materials and gather information about future targets. The bombers who struck in London last July relied heavily on the internet to plan their attack. But Mr Weimann is dismissive of the dangers of “cyberterrorism”—the much-hyped notion that attacks can be mounted over the internet itself, disabling power stations and other items of critical infrastructure by breaking into their computer systems. No such attacks have taken place, he points out, and no computers captured from known terrorists have even contained evidence that such attacks were being planned. Terrorists regard the internet, it seems, as a tool to facilitate real-world attacks, not an arena for terrorism in itself.

In which case, what can be done to prevent terrorists exploiting the internet? Just as they use electricity, cars and telephones, it would be surprising if terrorists did not use the internet too. It is important not to blame technologies for the misdeeds of their users—or to hinder the numerous beneficial uses of a technology by the many in order to prevent a small number of bad uses by the few. Some civil liberties should be traded for increased security, Mr Weimann suggests. But he warns that overly draconian surveillance of the internet's users, the vast majority of whom are not terrorists, would constitute a cure worse than the disease. He ends his book with a call for greater use of the internet as a peacemaking tool—an unconvincing conclusion to an otherwise informative and comprehensive analysis.

Terror on the Internet: The New Arena, the New Challenges.
By Gabriel Weimann.
United States Institute of Peace Press; 309 pages; $24.95

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

China's Long March

The long and winding road

Apr 27th 2006
From The Economist print edition

SEPARATING myth from reality in China is a challenge at the best of times. This is particularly true of the Long March, the famous journey that China's beleaguered communists made in the 1930s to a new base several thousand miles in the north of the country. Only a few of those who participated are still alive today. The Communist Party tolerates only one view: that it was utterly heroic. Debate about what really happened is suppressed. Parts of the route through some of the country's most inhospitable terrain are difficult for researchers to follow.

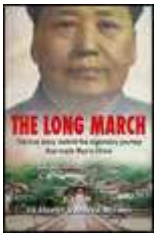
With the approach of this October's 70th anniversary of the official end of the march, two new books attempt to explore the truth of what both describe as communist China's "founding myth". Their efforts follow the publication last year of an iconoclastic biography of Mao Zedong by Jung Chang and Jon Halliday that dismisses the Long March as "one of the biggest myths of the 20th century". Ms Chang and Mr Halliday say Mao was borne on a litter and that China's then ruler, Chiang Kai-shek, made no more than a token effort to stop them.

Historians of the Long March are challenged by the passage of time and a dearth of first-hand accounts other than by party leaders. It was not until 1984 that Harrison Salisbury, an American journalist, became the first foreigner to be given permission to retrace the Long March. Few other independent writers have done it since. The accounts of ordinary marchers interviewed in the two latest works, one by a Chinese-born film producer, Sun Shuyun, and the other by two British journalists, Andrew McEwen and Ed Jocelyn, provide no more than isolated glimpses subject to the distortions of fading memories.

In party propaganda, the most iconic episode of the march was the crossing of a narrow suspension bridge over the turbulent Dadu River in Sichuan Province. Red Army soldiers are said to have crawled over its chains and burning planks under enemy fire. With remarkably few casualties they supposedly defeated two battalions on the other side. Edgar Snow, who with Mao's help wrote the first foreign account of the Long March, which was published in 1937, called this "the most critical single incident".

The bridge is now one of the fiercest battlegrounds between myth and reality. Ms Chang and Mr Halliday say there simply was no battle at all. The enemy had withdrawn before the communists arrived in May 1935. A 93-year-old woman interviewed by the authors in 1997 said she could not remember any shots directed at the Red Army. Messrs McEwen and Jocelyn and find a woman in

The Long March: The True Story Behind the Legendary Journey That Made Mao's China
By Andrew McEwen and Ed Jocelyn



Constable & Robinson; 350 pages; £8.99

Buy it at Amazon.co.uk

The Long March
By Sun Shuyun

HarperCollins; 302 pages; £20

Buy it at Amazon.co.uk

her early 80s who remembers differently. She recalls that local people led the way across the bridge and were all shot and killed. Ms Sun's book bases its account on the recollection of yet another ageing local. This witness says there was a small enemy force on the other side armed with guns that could “only fire a few metres”. They panicked and fled.

What about the planks, half of which Snow says were removed by the enemy with the others set on fire with paraffin? Smoke and flames feature heavily in Mao-era propaganda art. According to Ms Chang and Mr Halliday, there may have been some missing planks but they were not burned. Messrs McEwen and Jocelyn believe that at least half the planks had been removed, though their witness says there were only chains left. Ms Sun insists that planks had been removed only at one end; she sidesteps the question of fire.

The new accounts are enjoyable to read. They help convey the ordeals suffered by the marchers, and as Ms Sun describes particularly vividly, by some of those they encountered. Messrs McEwen and Jocelyn find the Long March was only half the length Mao made it out to be, though still a punishing 3,750 miles. China can rest assured that its cherished myths will long endure.

The Long March: The True Story Behind the Legendary Journey That Made Mao's China.
By Andrew McEwen and Ed Jocelyn.
Constable & Robinson; 350 pages; £8.99

The Long March.
By Sun Shuyun.
HarperCollins; 302 pages; £20

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

German banking

What if...

Apr 27th 2006
From The Economist print edition

ON NOVEMBER 30th 1989, a terrorist bomb killed Alfred Herrhausen on his way to work. Herrhausen carried the unilluminating title of “spokesman of the board of managing directors of Deutsche Bank”. In reality, he was the head of the biggest bank in West Germany. The Red Army Faction, in one of its last operations, had taken out the most influential business leader in Europe of the time.

And what a time it was: the Berlin Wall had just been breached, the Soviet Union was falling apart, and Mexico, Brazil and Poland all needed to restructure their debt. Herrhausen was deeply involved in all three areas: as adviser to Chancellor Helmut Kohl, as the arranger of the Soviet Union's last big credit and as the spearhead of an initiative to link debt forgiveness with a country's readiness to undergo political and economic reform.

Alfred Herrhausen: Eine deutsche Karriere
By Andreas Platthaus

Rowohlt-Berlin Verlag; 320 pages; €19.90

Buy it at Amazon.de

At the same time, he was trying to turn Deutsche Bank upside down. In fact he wanted to reform the entire international banking system. For Herrhausen was a rare creature, a man of great ability who was dedicated to getting things done. “The world,” he said in his best remembered speech, “is not a debating club.”

Herrhausen tried desperately to reconcile his role with the philosophical writings of Karl Popper, Friedrich Hayek, Wolfgang Stegmüller and even Confucius, whose writings he kept in his office. He was unashamedly patriotic and unashamedly elitist, but with an elitism he hoped was dedicated to serving the public good.

That made him unpopular with the old guard in his own bank who never really accepted him. Herrhausen had joined as a board member in 1970 from the Ruhr power utility, Vereinigte Elektrizitaetswerke Westfalen (VEW). To many he was the embodiment of Deutschland AG, the matrix of power that links banks and industrial companies. He sat on the supervisory boards of Daimler-Benz, a huge industrial group, and Continental, a tyre company. He led an initiative to revive the Ruhr, started a private university and began a foundation to help the disadvantaged become more self-sufficient.

He also made mistakes, such as helping his friend Edzard Reuter, head of Daimler- Benz, to merge the company with Messerschmidt-Bölkow-Blohm, maker of defence equipment, creating a value-destroying behemoth. His fans forgave him, but his enemies kept on plotting. Twice he offered to resign from the bank: first, in 1977 after he divorced, which was unheard of for a board member of Deutsche Bank; second, two days before he was murdered. Twice too, feeling himself blocked, he nearly quit to take the top job at Continental, and then at Daimler. But his mentor Hermann Josef Abs, who had headed the bank during the war, kept him loyal.

The day before his murder, Herrhausen told his wife he could no longer work with his fellow board members. He was determined to transform the bank into a pan-European powerhouse in readiness for 1992, the target date for the single European market. Herrhausen seemed arrogant, but he was not. He was impatient for action. He could electrify an audience, even at mundane events such as an annual general meeting. At the World Bank/IMF meeting in Berlin two months before his death the attention he received was more appropriate to a pop star than a banker. His support for debt forgiveness in the third world enraged many of his peers and won him some friends among the anti-capitalists. But not enough. His murderers blamed Herrhausen for presiding over a bank that “stands at the forefront of the fascist capital structure and has for years been preparing an assault on the countries of eastern Europe”.

This book, which so far has been published only in German, draws attention to a vital figure. What would have become of Deutsche Bank, unified Germany and Europe if Herrhausen had lived through the 1990s? Helmut Kohl is quoted in the book as saying that the bank has still not recovered from his death. And the conduct of German economic policy these days seems uncannily like a debating club—all words and no action.

Alfred Herrhausen: Eine deutsche Karriere.
By Andreas Platthaus.
Rowohlt-Berlin Verlag; 320 pages; euro19.90

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

New cinema

Altman in excelsis

Apr 27th 2006
From The Economist print edition

No one but Robert Altman could have made "A Prairie Home Companion"

IT WAS a stroke of genius for Garrison Keillor to ask Robert Altman to make a film of his radio show, "A Prairie Home Companion". Mr Keillor is a humorist in the noble tradition of Fred Allen and Jean Shepherd. Meanwhile, Mr Altman—at 80, the recent recipient of a heart transplant and an honorary Oscar—has softened the satirical punches that rained down on show-business in Nashville to focus on what he and Mr Keillor have in common, namely a love of American oddballs and a passion for American music.

Stand by your man

As Mr Keillor's script would have it, the long-running show is finally being shut down. A hatchetman played by Tommy Lee Jones, sent by the new owners of the Fitzgerald Theatre, watches the last performance from the client's booth, where a bust of F. Scott Fitzgerald glowers at him. So it is *sub specie aeternitate* that the Keillor clan displays its talents, large and small, for the last time: Rhonda and Yolanda, the Johnson Sisters (Lily Tomlin and Meryl Streep), who have been finishing each others' sentences for 30 years; the Singing Cowpokes, Dusty and Lefty (Woody Harrelson and John C. Reilly), who deliver a final volley of blue-tinged dumb-Swede jokes with sovereign indifference to FCC regulations; Chuck (L.Q. Jones), an old trouper who may or may not have enough life in him to warble one last song and bring off one last tryst with The Lunch Lady (Marylouise Burke); and Guy Noir (Kevin Kline), Mr Keillor's parody of a hardboiled detective, who has been put in charge of security.

As Mr Keillor rambles through an account of how he started in radio, which keeps being interrupted by the tasks at hand, he is the perfect onscreen spokesman for Mr Altman's loopy

free-associative style. At the same time, no Altman film can resist the temptation to wrap things up with a Big Idea—in this case Death, played by Virginia Madsen in a white raincoat. Like her, the impending cancellation is inevitable, so the only suspense concerns what Yolanda's grim-faced daughter Lola (Lindsay Lohan) will sing when circumstances oblige her to make her impromptu debut at the end of the broadcast. Threatened at one point with “Amazing Grace”, the audience is let off easily with a sassy rendition of “Frankie and Johnnie”—the first of several endings for a film the director obviously doesn't want to end at all, any more than anyone else does.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Van Gogh and Gauguin

Sunny side down

Apr 27th 2006
From The Economist print edition

TWO more mismatched housemates than Vincent van Gogh and Paul Gauguin would be hard to find. Van Gogh was unkempt, emotionally unstable and talked incessantly while he worked. Gauguin, a former sailor and businessman, was taciturn, orderly and a loner. Yet from October to December 1888, the two shared a four-roomed yellow house in Arles until, after a quarrel, Van Gogh cut off his ear. Gauguin fled for Paris and the two never saw each other again.

Martin Gayford's new book analyses the influence of this brief, failed effort to form a “school of the south”, an artistic brotherhood inspired by the brightly lit landscape of Provence. Van Gogh sold only one picture in his lifetime, which was painted during this time. On May 2nd, another crucial work from the period, “l'Arlesienne, Madame Ginoux” is due to go under the hammer at Christie's with an estimate of $40m-50m.

Van Gogh was the first artist to migrate to the south of France. Isolated in Arles, he pined for a friend to talk to about art. He begged Gauguin to join him there, even decorating a bedroom for his guest with paintings such as “Sunflowers”, an expression of the intense heat and colour that Van Gogh sought in his art.

The Yellow House: Van Gogh, Gauguin and Nine Turbulent Weeks in Arles
By Martin Gayford

Little, Brown; 352 pages; $24.99
Penguin; 356 pages; £18.99

Buy it at
Amazon.com
Amazon.co.uk

For Gauguin, the arrangement was more prosaic: he could live cheaply in Arles to save money for his next trip to the tropics. Mr Gayford attempts to recreate the claustrophobic atmosphere of the yellow house, with its small studio in which the two men were cooped up during the months of the *mistral*. He sees this period as a turning point in the work of each artist and in the history of art, and he chronicles every day, sometimes every hour, of their life together. This is both the book's strength and its weakness. For interesting though it is to learn of their “hygienic” visits to the brothel, Gauguin's talent as a cook and Van Gogh's voracious reading habits, the book becomes so bogged down in quotidian details that at times it loses the plot.

Nonetheless, it is worth reading for its fascinating discussion of the two painters' opposing approaches to their art. Gauguin believed in painting “from the head”: from the imagination and from memory, slowly bringing together elements on canvas in a symbolic and cerebral way. Van Gogh, on the other hand, wanted to paint directly from nature. Not only did he find it exhilarating to respond spontaneously to the colour all around him, he also found it consoling; it helped release the flood of ideas exploding in his head. Van Gogh, Mr Gayford says, suffered from bi-polar disorder, a severe form of manic depression which can now be treated with lithium but which then was undiagnosed. Ruminating on art, as Gauguin advised, was dangerous for Van Gogh, bringing back painful memories that drove him mad.

The difference between the two can be seen in two pictures that Van Gogh painted of chairs. Like the iconic painting of the bedroom, which he did before Gauguin's arrival, these were manifestos of Van Gogh's artistic beliefs. His chair is a simple rush-bottomed seat painted in sunny, yellow tones. On it he placed a peasant's pipe and tobacco and behind the chair a box of sprouting onions, a symbol of nature and the new life that might grow from art. The armchair he painted for Gauguin is more substantial, with a gaslight behind it creating a mysterious, nocturnal effect. On its seat, Van Gogh placed two novels and a candle that stood for the inspiration of the mind and intellectual light—references to Gauguin's more cerebral method of painting.

The picture that sums up their collaboration best, though, is the portrait of Madame Ginoux. Van Gogh based it on a drawing by Gauguin. It was an olive branch to his by-then estranged friend and a plea for him to return to the yellow house, where they had once depicted this middle-aged proprietress of a local cafe. Van Gogh translated Gauguin's sober sketch into the muted colours he saw as more typical of Gauguin. In a touching letter, he called it a synthesis of their artistic experiment in Arles: “Take this as a work belonging to you and me as a summary of our months of work together.” It is, in a sense, the best of both of their worlds.

The Yellow House: Van Gogh, Gauguin and Nine Turbulent Weeks in Arles.
By Martin Gayford.
Penguin; 356 pages; £18.99

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Shin Sang-Ok

Apr 27th 2006
From The Economist print edition

Shin Sang-Ok, film director and abductee, died on April 11th, aged 79

AFP

VIEWERS of the movie “Team America: World Police” will have gathered that North Korea's dictator, Kim Jong Il, is a mixed-up fellow. He may be brutal—he is depicted feeding Hans Blix, the former UN weapons inspector, to a shark—but he is also a sensitive, artistic soul. After murdering Mr Blix, he sings a sad song about how lonely it is being a psychotic despot. This was supposed to be outrageous satire. But, as Shin Sang-Ok could have told the directors, no fictionalised “Dear Leader” could be weirder, or nastier, than the real one.

Mr Shin was a South Korean movie director. In 1978, Mr Kim, a movie buff, had him kidnapped and whisked to the hermit kingdom to make its revolutionary film industry less awful.

Before then, Mr Shin was best known for giving South Korean audiences their first on-screen kiss. During the 1950s and 1960s he made dozens of films, several of which depicted Korean women's struggles against patriarchal convention. His favourite leading lady was his wife, the dazzling Choi Eun-Hee. In the 1970s Mr Shin's career waned, and it came to an abrupt halt when he upset South Korea's military government by complaining about censorship. His movie company was swiftly shut down.

Mr Kim, then the unacknowledged heir apparent to the world's first hereditary communist monarchy, saw his opportunity. First, he had Ms Choi lured to Hong Kong, kidnapped and shipped to a North Korean port. Ever the gentleman, he turned up at the dock to greet her. “Thank you for coming, Madame Choi,” he said, as if she were stepping off a cruise ship.

Although they had recently divorced, Mr Shin was naturally alarmed at his ex-wife's disappearance. He followed her trail to Hong Kong, where he too was abducted. In North Korea, he was put up in a comfortable guest house, but insisted on trying to escape. One day he borrowed a car, drove to a railway station, hid among crates of explosives and crept aboard a freight train. He was caught the next day, and soon found himself in a hellish prison camp.

Even there, however, he was protected from afar. When he tried to starve himself to death, officials force-fed him through a funnel. A guard told Mr Shin that he was the first attempted suicide he'd ever seen saved—so he must be very important.

After four years, Mr Shin won his release through a series of abjectly apologetic letters to Kim Jong Il and his father, President Kim Il Sung. He was brought to a dinner party in Pyongyang, the capital, and face-to-face with his ex-wife, who had not known until that moment that he was in North Korea. “Well, go ahead and hug each other. Why are you just standing there?” said the Dear Leader, who then suggested that they re-marry. They did as they were told.

At last, Mr Shin's talents could be put to good use. Mr Kim was worried that films produced in decadent, capitalist South Korea were better than those produced in the North. Perceptively, he explained to Mr Shin that this was because North Korean film workers knew the state would feed them regardless of the quality of their output. In the South, by contrast, actors and directors had to sweat to make films the public would pay to see. Mr Kim wasn't saying that there was anything wrong with socialism, of course, but he gave Mr Shin millions of dollars, a fancy marble-lined office and more artistic freedom than any North Korean director had ever enjoyed before.

Films fit for Cannes

Mr Kim did not want Mr Shin to make crude propaganda. Oh no. He wanted films that would win awards at international festivals. And although the tubby tyrant had previously argued, in his book “On the Art of Cinema”, that good movies should glorify the party, the system, his father and himself, he realised that this was not a fail-safe formula for wowing the judges at Cannes.

So he let Mr Shin shoot some watchable films, including “Pulgasari”, a Godzilla-inspired affair about a metal-eating monster who helped 14th-century peasants overthrow their feudal lords. The director and his wife were obliged to give a press conference explaining that they had willingly defected to North Korea, but otherwise they were treated far better than most of the Kim dynasty's hapless subjects. Mr Kim must have thought that was good enough to keep them loyal, for he allowed them to travel. As soon as they saw a chance to dodge their bodyguards, during a promotional trip to Vienna in 1986, they fled to the American embassy and sought asylum.

Mr Shin was at first reluctant to go home, for fear that South Korea's security police might disbelieve his fantastic tale and suspect him of communist sympathies. Fortunately, he and his wife had made, at mortal risk, clandestine tape recordings of conversations with Mr Kim. These, and the couple's memoirs, are among the most useful accounts we have of the secretive (and now probably nuclear-armed) Dear Leader's personality: charming, shrewd, quirky, malevolent.

Mr Shin continued to make films until shortly before he died. His last years were frail; he had a liver transplant in 2004. Ms Choi survived him, and his last film, about an old man with Alzheimer's, is yet to be released.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Overview

Apr 27th 2006
From The Economist print edition

Oil prices hit a new high of $75 for a barrel of West Texas Intermediate crude on April 21st. They fell afterwards, but remained above $70 a barrel. High petrol prices caused a political furore in America, prompting President George Bush to suspend deliveries to the country's strategic oil reserve and promise an investigation into possible price gouging.

Long-term **interest rates** are also rising. The yield on ten-year American Treasury bonds rose above 5.1% and hit a four-year high.

Despite soaring prices at the petrol pump, America's consumers are upbeat. The Conference Board's index of **consumer confidence** rose to 109.6 in April, the highest in four years. Thanks largely to an improvement in their assessment of the jobs market, consumers were cheery both about their situation today and also their prospects for the future.

America's firms, too, are optimistic. Orders of durable goods, a leading indicator of **business investment**, rose by 6.1% in March, the largest gain in almost a year and much more than analysts expected.

Germany's businessmen are growing ever more confident. The Ifo business-climate index rose for the fifth consecutive month in April, to 105.9. Businessmen were especially upbeat about today and slightly less confident about future conditions.

High oil prices pushed up Germany's **inflation** rate. Consumer prices rose by 2.0% in the year to April, up from 1.8% in the year to March. The combination of accelerating consumer prices and strong business confidence in the largest economy of the euro area prompted speculation that the European Central Bank would raise short-term interest rates again at its next meeting on May 4th.

Canada's central bank raised short-term interest rates by a quarter-point to 4% and suggested that more tightening might be necessary.

Britain's economy grew by 2.2% in the year to the first quarter. Retail sales were 2.6% higher in March than a year earlier.

Australia's rate of consumer-price inflation rose to 3.0% in the year to the first quarter, up from 2.8% in the last quarter of 2005 and slightly higher than expected.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Output, demand and jobs

Apr 27th 2006
From The Economist print edition

% change on year ago

	GDP		The Economist poll GDP forecasts		Industrial production		Retail sales (volume)		Unemployment % rate		
	latest	qtr*	2006	2007	latest		latest		latest		year ago
Australia	+ 2.7 Q4	+ 1.9	+ 3.1	+ 3.4	+ 0.6	Q4	+ 1.9	Q4	5.0	Mar	5.2
Austria	+ 2.1 Q4	+ 2.8	+ 2.2	+ 1.9	+ 8.2	Jan	+ 4.5	Jan	5.0	Mar	5.1
Belgium	+ 2.2 Q1	+ 3.2	+ 2.2	+ 1.8	+ 6.3	Feb	– 2.5	Jan	12.2	Mar†	12.6
Britain	+ 2.2 Q1	+ 2.6	+ 2.3	+ 2.4	– 1.4	Feb	+ 2.6	Mar	5.1	Feb‡	4.8
Canada	+ 2.9 Q4	+ 2.5	+ 3.1	+ 2.8	+ 0.9	Jan	+ 4.4	Jan	6.3	Mar	6.9
Denmark	+ 3.3 Q4	– 0.1	+ 2.8	+ 2.2	+ 7.1	Feb	+ 3.8	Feb	4.8	Mar	6.0
France	+ 1.5 Q4	+ 1.4	+ 2.0	+ 2.0	– 0.3	Feb	+ 1.7	Feb	9.6	Feb	10.1
Germany	+ 1.0 Q4	nil	+ 1.8	+ 1.2	+ 6.4	Feb	+ 1.1	Feb	11.3	Apr§	11.9
Italy	+ 0.5 Q4	+ 0.1	+ 1.2	+ 1.1	+ 3.4	Feb	+ 0.2	Jan	7.7	Dec	7.9
Japan	+ 4.0 Q4	+ 5.4	+ 3.0	+ 2.4	+ 3.7	Feb	– 0.2	Feb	4.1	Feb	4.6
Netherlands	+ 1.6 Q4	+ 3.2	+ 2.5	+ 1.9	+ 0.6	Feb	+ 7.4	Jan	5.9	Mar††	6.7
Spain	+ 3.5 Q4	+ 3.9	+ 3.1	+ 2.7	+ 2.3	Feb	+ 0.1	Feb	8.7	Feb	9.9
Sweden	+ 2.9 Q4	+ 2.6	+ 3.3	+ 2.8	+ 1.5	Feb	+ 7.7	Feb	5.5	Mar†	6.0
Switzerland	+ 2.7 Q4	+ 2.1	+ 2.3	+ 1.7	+ 3.9	Q4	+ 0.4	Feb	3.6	Mar†	3.9
United States	+ 3.2 Q4	+ 1.7	+ 3.3	+ 2.8	+ 3.6	Mar	+ 5.1	Feb	4.7	Mar	5.1
Euro area	+ 1.7 Q4	+ 1.0	+ 2.1	+ 1.7	+ 3.2	Feb	+ 1.0	Feb	8.2	Feb	8.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 2.9 Q4	+ 3.7	na	na	+ 3.5	Feb	+ 4.5	Feb	7.9	Mar	8.3
Greece	+ 3.7 Q4	na	na	na	– 1.7	Feb	+ 0.5	Jan	9.7	Q4	10.4
Iceland	+ 3.6 Q4	na	na	na	na		na		1.6	Feb†	2.8
Ireland	+ 5.7 Q4	+ 7.6	na	na	– 5.2	Feb	+ 6.0	Feb	4.5	Mar	4.4
Luxembourg	+ 3.1 Q1	na	na	na	+12.7	Jan	+ 9.1	Feb	4.7	Feb	4.4
New Zealand	+ 1.9 Q4	nil	na	na	– 2.9	Q4	+ 3.0	Q4	3.6	Q4	3.6
Norway	+ 2.5 Q4	+ 1.0	na	na	+ 0.5	Feb	+ 2.8	Feb	3.9	Feb**	4.6
Portugal	+ 0.7 Q4	+ 0.4	na	na	– 1.5	Feb	+ 3.0	Feb	8.0	Q4†	7.1

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡Dec-Feb; claimant count rate 3.0% in Mar.
§EU harmonised rate 8.9% in Feb. ††Jan-Mar. **Dec-Feb.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Prices and wages

Apr 27th 2006
From The Economist print edition

% change on year ago

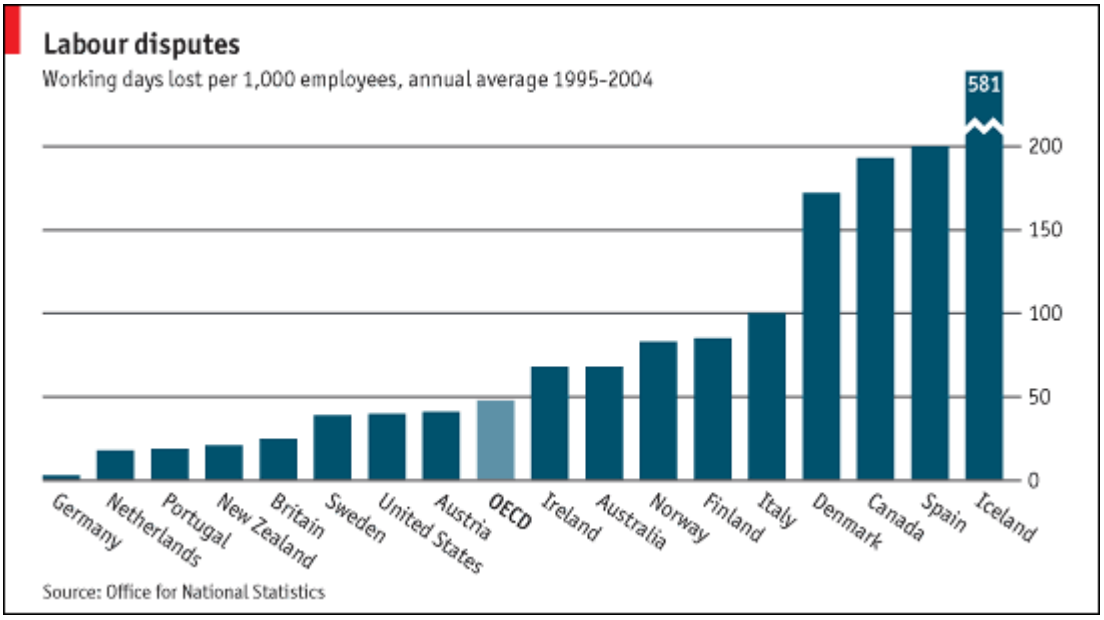
	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2006	2007	latest		year ago	latest		year ago
Australia	+ 3.0	Q1	+ 2.4	+ 2.8	+ 2.7	+ 7.9	Q1	+ 6.0	+ 5.3	Q4	+ 2.9
Austria	+ 1.0	Mar	+ 2.9	+ 1.9	+ 1.8	+ 1.9	Mar	+ 4.0	+ 2.7	Mar	+ 2.2
Belgium	+ 1.7	Mar	+ 3.1	+ 2.1	+ 1.8	+ 3.7	Feb	+ 4.3	+ 2.3	Oct	+ 2.4
Britain	+ 1.8	Mar*	+ 1.9	+ 2.0	+ 1.9	+ 2.5	Mar	+ 2.9	+ 4.2	Feb†	+ 4.6
Canada	+ 2.2	Mar	+ 2.3	+ 2.1	+ 2.1	+ 0.6	Feb	+ 2.8	+ 0.6	Jan	+ 2.0
Denmark	+ 1.9	Mar	+ 1.4	+ 1.9	+ 2.0	+ 3.8	Mar	+ 4.2	+ 2.9	Q4	+ 2.9
France	+ 1.5	Mar	+ 1.9	+ 1.7	+ 1.5	+ 3.5	Feb	+ 3.1	+ 3.3	Q4	+ 3.0
Germany	+ 2.0	Apr	+ 1.6	+ 1.6	+ 2.3	+ 2.5	Mar	+ 3.3	+ 1.5	Feb	+ 1.2
Italy	+ 2.1	Mar	+ 1.9	+ 2.1	+ 1.9	+ 4.9	Feb	+ 4.7	+ 2.6	Feb	+ 3.4
Japan	+ 0.5	Feb	− 0.3	+ 0.4	+ 0.6	+ 2.7	Mar	+ 1.4	+ 0.4	Feb	+ 0.1
Netherlands	+ 1.0	Mar	+ 1.8	+ 1.6	+ 1.5	+ 5.6	Feb	+ 5.2	+ 1.7	Mar	+ 0.6
Spain	+ 3.9	Mar	+ 3.4	+ 3.5	+ 2.8	+ 5.8	Mar	+ 5.1	+ 2.5	Q4	+ 2.7
Sweden	+ 1.1	Mar	+ 0.1	+ 1.2	+ 1.8	+ 5.1	Mar	+ 2.5	+ 3.4	Dec	+ 2.0
Switzerland	+ 1.0	Mar	+ 1.4	+ 1.2	+ 1.2	+ 1.6	Mar	+ 1.4	+ 0.9	2004	+ 1.4
United States	+ 3.4	Mar	+ 3.1	+ 3.0	+ 2.3	+ 3.5	Mar	+ 4.9	+ 3.4	Mar	+ 2.6
Euro area	+ 2.2	Mar	+ 2.1	+ 2.0	+ 2.0	+ 5.4	Feb	+ 4.2	+ 2.4	Q4	+ 2.4
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 0.9	Mar	+ 1.0	na	na	+ 5.3	Mar	+ 2.4	+ 3.5	Q4	+ 4.3
Greece	+ 3.3	Mar	+ 2.9	na	na	+ 8.9	Feb	+ 4.1	na		na
Iceland	+ 4.5	Apr	+ 4.3	na	na	+ 5.3	Apr	+ 6.6	+ 8.6	Mar	+ 6.5
Ireland	+ 3.5	Mar	+ 2.1	na	na	+ 3.3	Feb	− 0.4	+ 3.8	Q4	+ 4.6
Luxembourg	+ 3.0	Mar	+ 2.4	na	na	+ 3.9	Feb	+17.7	+ 2.5	Jan	+ 0.2
New Zealand	+ 3.3	Q1	+ 2.8	na	na	+ 6.5	Q4	+ 3.4	+ 3.1	Q4	+ 2.5
Norway	+ 2.4	Mar	+ 1.0	na	na	+15.1	Mar	+17.5	+ 3.1	Q4	+ 3.9
Portugal	+ 3.1	Mar	+ 2.2	na	na	+ 5.4	Mar	+ 4.6	nil	Feb	− 1.5

*RPI inflation rate 2.4% in Mar. †Dec-Feb.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Labour disputes

Apr 27th 2006
From The Economist print edition



Iceland has the most fractious industrial relations in the OECD. Its strike rate—the number of days lost to labour disputes per 1,000 employees—averaged 581 days a year from 1995-2004. In 1995, its worst year, Iceland lost almost two days to strikes for every worker in the economy. The OECD strike rate of 39 in 2004 was higher than the year before, but lower than its average over the preceding decade.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Money and interest rates

Apr 27th 2006
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Apr 26th 2006)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 6.7	+ 7.5	Feb	5.74	5.73	5.62	5.70	5.39	6.80
Britain	+ 6.7	+12.4	Mar	4.61	4.88	4.63	4.67	4.54	5.11
Canada	+10.0	+ 6.4	Feb	4.01	2.45	4.19	4.55	4.21	5.61
Denmark	+18.3	+16.9	Mar	2.88	2.18	3.37	4.00	3.44	5.36
Japan	+ 5.0	+ 1.5	Mar	0.04	0.02	0.64	1.92	1.26	2.02
Sweden	+ 1.3	+ 8.8	Feb	2.06	1.97	2.99	3.87	3.39	3.75
Switzerland	+ 1.6	+ 4.7	Mar	1.31	0.76	1.79	2.69	2.06	2.81
United States	+ 0.8	+ 4.7	Mar‡	4.90	3.12	4.94	5.10	4.23	6.06
Euro area†	+ 9.9	+ 8.0	Feb	2.82	2.13	3.37	3.95	3.38	4.47

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. ‡New series for broad money supply. Benchmarks: US 30-year 5.18%, Japan No. 278 1.94%. Central bank rates: US fed funds 4.75%, ECB refinancing 2.50%, BOJ overnight call 0.001%, BOE repo 4.50%. Sources: Bank of Canada, Commerzbank, Danske Bank, Global Insight, JPMorgan Chase, Stockholmsbörsen, UBS, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The Economist commodity price index

Apr 27th 2006
From The Economist print edition

2000=100

	Apr 18th	Apr 25th*	% change on one month	% change on one year
Dollar index				
All items	166.7	171.3	+ 9.3	+27.0
Food	135.2	136.0	+ 1.7	+ 4.7
Industrials				
All	207.4	216.9	+16.2	+53.6
Nfa†	149.2	149.5	+ 0.9	+15.1
Metals	239.1	253.7	+22.2	+72.0
Sterling index				
All items	142.2	145.3	+ 6.9	+35.2
Euro index				
All items	125.5	127.7	+ 6.4	+32.7
Yen index				
All items	181.9	182.4	+ 7.4	+37.5
Gold				
$ per oz	616.25	630.25	+11.0	+44.6
West Texas Intermediate				
$ per barrel	71.25	72.29	+ 9.5	+33.9

*Provisional. †Non-food agriculturals.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Stockmarkets

Apr 27th 2006
From The Economist print edition

Market indices

	Apr 26th	2006 high	2006 low	% change on one week	% change on record high	% change on Dec 30th 2005 in local currency	% change on Dec 30th 2005 in $ terms
Australia (All Ordinaries)	5,272.1	5,272.1	4,708.8	+ 0.7	nil	+12.0	+14.9
Austria (ATX)	4,302.4	4,302.4	3,682.4	+ 1.8	nil	+17.3	+23.8
Belgium (Bel 20)	3,928.3	3,978.0	3,573.9	+ 1.7	- 1.2	+10.7	+16.7
Britain (FTSE 100)	6,104.3	6,132.7	5,618.8	+ 0.2	-11.9	+ 8.6	+13.1
Canada (Toronto Composite)	12,321.7	12,487.3	11,272.3	- 1.3	- 1.3	+ 9.3	+13.2
Denmark (OMXCB)	379.7	395.5	362.0	+ 2.4	- 4.0	+ 3.2	+ 8.8
France (SBF 250)	3,717.4	3,717.4	3,327.6	+ 1.9	-15.3	+12.6	+18.8
(CAC 40)	5,252.3	5,255.3	4,748.3	+ 1.8	-24.1	+11.4	+17.5
Germany (DAX)*	6,107.1	6,107.1	5,334.3	+ 1.9	-24.3	+12.9	+19.1
Italy (S&P/MIB)	38,341.0	38,602.0	35,652.0	+ 0.8	-23.5	+ 7.4	+13.3
Japan (Nikkei 225)	17,055.9	17,563.4	15,341.2	- 1.7	-56.2	+ 5.9	+ 8.8
(Topix)	1,723.3	1,783.7	1,572.1	- 1.4	-40.3	+ 4.5	+ 7.3
Netherlands (AEX)	477.5	478.0	431.5	+ 1.8	-31.9	+ 9.3	+15.3
Spain (Madrid SE)	1,298.5	1,298.5	1,156.8	+ 1.8	nil	+12.3	+18.5
Sweden (Affarsvarlden Gen)	330.9	333.6	287.3	- 0.2	-17.3	+12.8	+19.8
Switzerland (Swiss Market)	8,071.1	8,109.3	7,583.9	+ 0.3	- 4.1	+ 6.4	+10.5
United States (DJIA)	11,354.5	11,354.5	10,667.4	+ 0.7	- 3.1	+ 5.9	+ 5.9
(S&P 500)	1,305.4	1,311.6	1,248.3	- 0.3	-14.5	+ 4.6	+ 4.6
(NASDAQ Comp)	2,333.6	2,370.9	2,205.3	- 1.6	-53.8	+ 5.8	+ 5.8
Europe (FTSEurofirst 300)†	1,391.0	1,397.1	1,277.1	+ 0.5	-18.4	+ 9.0	+15.0
Euro area (FTSE Euro 100)†	1,195.5	1,196.7	1,078.9	+ 1.6	-22.9	+ 9.8	+15.8
World (MSCI)‡	1,369.5	1,370.0	1,259.1	+ 0.4	- 5.5	+ 8.9	+ 8.9
World bond market (Citigroup)††	625.8	638.9	612.1	+ 0.9	- 2.1	+ 0.9	+ 0.9

*Total return index. †In euro terms. ‡Morgan Stanley Capital International Index includes individual markets listed above plus eight others, in $ terms. ††Citigroup World Government Bond Index, total return, in $ terms.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Trade, exchange rates and budgets

Apr 27th 2006
From The Economist print edition

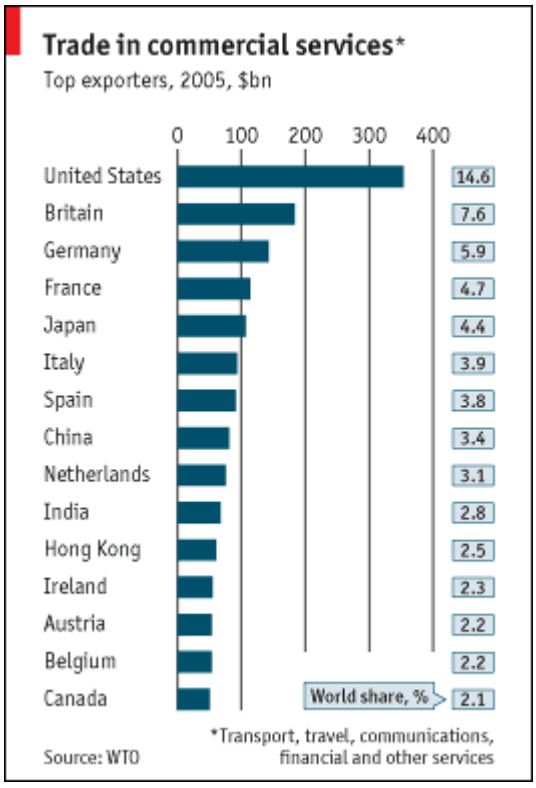
	Trade balance*, $bn latest 12 months		Current-account balance $bn latest 12 mths		The Economist poll % of GDP, forecast 2006	2007	Exchange rate trade-weighted† 2000=100 Apr 26th	year ago	Currency units per $ Apr 26th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2005‡
Australia	− 12.8	Feb	− 42.1	Q4	− 5.5	− 5.0	117.9	115.7	1.33	1.29	2.37	1.65	1.16	+ 1.0
Austria	− 2.0	Feb	+ 0.5	Dec	+ 0.1	+ 0.1	104.8§	105.8	0.80	0.77	1.44	–	0.70	− 2.0
Belgium	+ 12.3	Feb	+ 6.6	Dec	+ 2.0	+ 2.1	106.4§	107.7	0.80	0.77	1.44	–	0.70	nil
Britain	−121.5	Feb	− 57.4	Q4	− 2.5	− 2.5	97.6	101.5	0.56	0.52	–	0.70	0.49	− 3.1
Canada	+ 59.9	Feb	+ 25.2	Q4	+ 2.2	+ 1.6	128.2	114.8	1.13	1.25	2.02	1.40	0.98	+ 1.3
Denmark	+ 8.7	Feb	+ 6.0	Feb	+ 2.7	+ 2.5	106.3	106.3	6.00	5.74	10.7	7.46	5.22	+ 2.8
France	− 30.3	Feb	− 43.5	Feb	− 1.6	− 1.3	107.1§	108.6	0.80	0.77	1.44	–	0.70	− 3.2
Germany	+195.8	Feb	+113.3	Feb	+ 3.9	+ 4.1	108.5§	110.2	0.80	0.77	1.44	–	0.70	− 3.9
Italy	− 16.3	Feb	− 28.5	Feb	− 1.5	− 1.4	106.7§	108.1	0.80	0.77	1.44	–	0.70	− 4.3
Japan	+ 86.5	Feb	+163.4	Feb	+ 3.7	+ 3.6	82.5	87.9	115	106	205	143	–	− 6.5
Netherlands	+ 39.1	Feb	+ 39.8	Q4	+ 5.7	+ 5.6	107.2§	108.5	0.80	0.77	1.44	–	0.70	− 1.6
Spain	− 98.8	Feb	− 82.3	Jan	− 7.3	− 7.4	105.1§	106.0	0.80	0.77	1.44	–	0.70	+ 0.3
Sweden	+ 19.3	Mar	+ 21.8	Q4	+ 6.5	+ 6.1	96.9	99.1	7.49	7.05	13.4	9.32	6.52	+ 1.2
Switzerland	+ 7.5	Mar	+ 50.2	Q4	+13.0	+12.3	105.3	107.9	1.27	1.19	2.27	1.58	1.11	− 1.6
United States	−798.3	Feb	−804.9	Q4	− 6.8	− 6.7	84.4	82.7	–	–	1.79	1.24	0.87	− 3.7
Euro area	+ 10.8	Feb	− 39.1	Feb	− 0.3	− 0.1	118.2	117.8	0.80	0.77	1.44	–	0.70	− 2.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 9.5	Feb	+ 4.2	Feb	na	na	107.9§	109.2	0.80	0.77	1.44	–	0.70	+ 2.1
Greece	− 34.5	Jan	− 19.6	Feb	na	na	104.1§	104.9	0.80	0.77	1.44	–	0.70	− 4.5
Iceland	− 1.6	Feb	− 2.6	Q4	na	na	106.2**	98.2	74.7	63.5	133	92.9	65.0	+ 2.0
Ireland	+ 38.9	Feb	− 3.9	Q4	na	na	111.7§	114.2	0.80	0.77	1.44	–	0.70	− 0.9
Luxembourg	− 4.9	Jan	+ 3.6	Q4	na	na	106.4§	107.7	0.80	0.77	1.44	–	0.70	− 2.3
New Zealand	− 4.8	Mar	− 9.6	Q4	na	na	124.7	136.7	1.58	1.38	2.83	1.97	1.38	+ 5.3
Norway	+ 51.1	Mar	+ 49.5	Q4	na	na	112.9	107.9	6.26	6.26	11.2	7.79	5.45	+ 15.3
Portugal	− 22.9	Jan	− 17.1	Feb	na	na	105.1**	106.6	0.80	0.77	1.44	–	0.70	− 6.0

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, February average. ‡OECD estimate.
**IMF, December average.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Trade in commercial services

Apr 27th 2006
From The Economist print edition



Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Overview

Apr 27th 2006
From The Economist print edition

South Korea's GDP grew by 6.2% in the year to the first quarter, up from 2.7% a year ago**.**

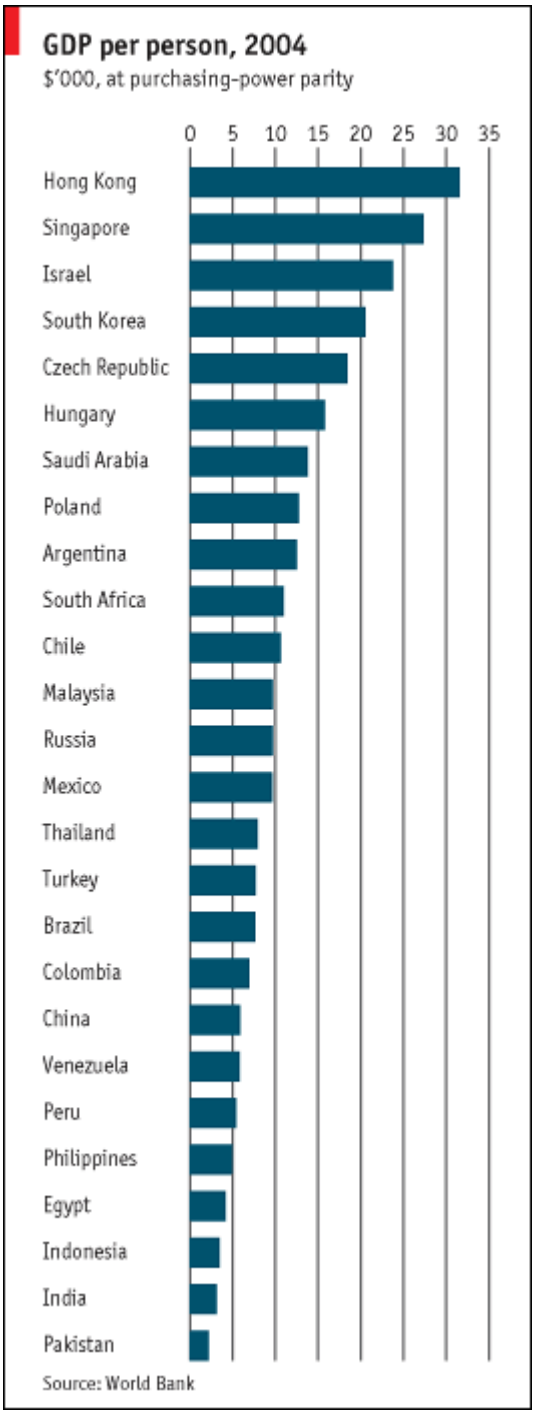
New figures showed that **Saudi Arabia's** current-account surplus rose to $91 billion in 2005—the second-biggest surplus (behind China) of all the countries in our table. **Mexico's** trade deficit narrowed to $4.9 billion in the year to March, half the size of the deficit a year earlier.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

GDP per person, 2004

Apr 27th 2006
From The Economist print edition

China is a big economy, but still a poor one. It ranked only 108th in income per head (measured at purchasing-power parity) in 2004, according to the latest World Development Indicators published by the World Bank. By this measure, Argentines were richer than Mexicans. But in terms of dollars per person, Mexicans were richer. This may reflect a cheap Argentine peso.



Economy

Apr 27th 2006
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+10.2	Q1	+17.8	Mar	+ 0.8	Mar	+108.1	Mar	+128.5	H1	875.1	Mar
Hong Kong	+ 7.6	Q4	+ 5.9	Q4	+ 1.8	Mar	−11.3	Feb	+19.7	Q4	125.9	Mar
India	+ 7.6	Q4	+ 8.8	Feb	+ 5.0	Feb	−39.4	Mar	−13.3	Q4	145.1	Mar
Indonesia	+ 4.9	Q4	−17.5	Feb	+15.7	Mar	+29.8	Feb	+ 3.0	Q4	33.8	Feb
Malaysia	+ 5.2	Q4	+ 5.8	Feb	+ 4.8	Mar	+26.8	Feb	+19.9	Q4	71.6	Feb
Pakistan	+ 8.4	2005†	+19.3	Sep	+ 6.9	Mar	−10.5	Mar	− 3.7	Q4	9.8	Feb
Philippines	+ 6.1	Q4	−11.8	Feb	+ 7.6	Mar	− 3.8	Feb	+ 2.4	Dec	18.0	Mar
Singapore	+ 9.1	Q1	+25.2	Mar	+ 1.2	Mar	+32.5	Mar	+33.2	Q4	122.2	Mar
South Korea	+ 6.2	Q1	+10.0	Mar	+ 2.0	Mar	+19.3	Mar	+ 9.6	Mar	217.3	Mar
Taiwan	+ 6.4	Q4	+ 7.2	Mar	+ 0.4	Mar	+ 8.9	Mar	+16.4	Q4	257.1	Mar
Thailand	+ 4.7	Q4	+12.8	Feb	+ 5.7	Mar	− 7.0	Feb	− 1.8	Feb	52.9	Feb
Argentina	+ 9.1	Q4	+ 3.7	Mar	+11.1	Mar	+11.3	Feb	+ 5.4	Q4	19.6	Feb
Brazil	+ 1.4	Q4	+ 5.4	Feb	+ 5.3	Mar	+45.8	Mar	+13.5	Feb	59.2	Mar
Chile	+ 5.8	Q4	+ 5.0	Feb	+ 4.0	Mar	+11.6	Mar	+ 0.7	Q4	16.0	Mar
Colombia	+ 3.7	Q4	+ 5.6	Feb	+ 4.1	Mar	+ 1.4	Jan	− 1.9	Q4	15.0	Mar
Mexico	+ 2.7	Q4	+ 5.4	Feb	+ 3.4	Mar	− 4.9	Mar	− 5.7	Q4	75.6	Feb
Peru	+ 4.9	Feb	+ 3.6	Feb	+ 2.5	Mar	+ 5.2	Feb	+ 1.0	Q4	13.4	Mar
Venezuela	+10.2	Q4	+13.6	Jan	+12.1	Mar	+31.5	Q4	+25.4	Q4	21.8	Jan
Egypt	+ 5.2	Q1§	+ 4.0	2005†	+ 4.0	Feb	−11.1	Q4	+ 2.2	Q4	21.8	Mar
Israel	+ 4.8	Q4	+ 8.4	Jan	+ 3.6	Mar	− 8.6	Mar	+ 2.4	Q4	28.0	Mar
Saudi Arabia	+ 6.2	2005‡	na		+ 1.5	Jan	+84.6	2004	+90.7	2005	23.2	Feb
South Africa	+ 4.5	Q4	+ 3.8	Feb	+ 3.4	Mar	− 4.7	Feb	−10.1	Q4	20.6	Mar
Czech Republic	+ 6.9	Q4	+11.8	Feb	+ 2.8	Mar	+ 1.7	Feb	− 2.6	Q4	29.8	Mar
Hungary	+ 4.3	Q4	+11.6	Feb	+ 2.3	Mar	− 3.3	Feb	− 8.0	Q4	21.5	Mar
Poland	+ 4.2	Q4	+16.4	Mar	+ 0.4	Mar	− 2.6	Feb	− 4.0	Feb	42.3	Mar
Russia	+ 7.0	Q4	+ 4.1	Mar	+10.6	Mar	+128.1	Feb	+84.3	Q1	205.9	Mar
Turkey	+ 9.5	Q4	+ 5.0	Feb	+ 8.2	Mar	−45.3	Feb	−24.7	Feb	56.5	Feb
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+11.1	Q4	+ 5.2	Feb	+ 4.0	Mar	− 2.6	Feb	− 1.5	Feb	1.9	Feb
Latvia	+10.5	Q4	+ 7.6	Feb	+ 6.5	Mar	− 3.2	Feb	− 2.1	Feb	2.4	Feb
Lithuania	+ 8.8	Q4	na		+ 3.1	Mar	− 3.8	Feb	− 1.8	Feb	4.2	Feb
Slovakia	+ 7.6	Q4	+ 5.5	Feb	+ 4.5	Mar	− 2.9	Feb	− 4.0	Dec	15.1	Jan
Slovenia	+ 5.1	Q4	+ 8.1	Feb	+ 1.9	Mar	− 1.7	Feb	− 0.3	Feb	8.5	Jan

*Excluding gold, except Singapore and China; IMF definition. †Year ending June. ‡Economist Intelligence Unit estimate. §2005.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

Financial markets

Apr 27th 2006
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Apr 26th		Dec 30th 2005	
	Apr 26th	year ago	Apr 26th	% a year		one week	in local currency	in $ terms
China	8.02	8.28	14.3	2.10	1,487.3	+1.6	+ 21.8	+ 22.6
Hong Kong	7.76	7.80	13.9	4.57	16,672.7	-0.9	+ 12.1	+ 12.1
India	45.1	43.7	80.5	5.39	11,938.5	+0.4	+ 27.0	+ 26.9
Indonesia	8,800	9,558	15,728	13.45	1,481.7	+2.0	+ 27.4	+ 42.5
Malaysia	3.64	3.80	6.51	3.60	949.3	+0.4	+ 5.5	+ 9.5
Pakistan	60.0	59.5	107	9.33	11,910.1	-1.1	+ 24.6	+ 24.1
Philippines	51.9	54.3	92.7	7.69	2,247.1	+1.1	+ 7.2	+ 9.6
Singapore	1.59	1.65	2.84	3.38	2,596.7	+0.4	+ 10.6	+ 15.9
South Korea	947	1,003	1,692	4.37	1,451.2	+0.9	+ 5.2	+ 12.4
Taiwan	32.1	31.4	57.3	1.70	7,169.0	+1.8	+ 9.5	+ 12.2
Thailand	37.7	39.5	67.3	5.10	770.4	+0.8	+ 7.9	+ 17.5
Argentina	3.04	2.90	5.44	9.88	1,919.7	+0.4	+ 24.4	+ 23.8
Brazil	2.12	2.52	3.79	15.68	40,410.0	+1.2	+ 20.8	+ 33.0
Chile	518	580	926	4.80	10,022.2	+1.0	+ 8.9	+ 7.6
Colombia	2,373	2,337	4,242	5.89	10,984.4	+0.8	+ 15.5	+ 11.2
Mexico	11.2	11.1	20.0	7.03	20,566.9	+3.2	+ 15.5	+ 10.1
Peru	3.32	3.26	5.92	4.23	7,089.0	+4.2	+ 47.6	+ 52.8
Venezuela	2,514§	2,701§	4,492	10.64	31,067.5	+0.4	+ 52.3	+ 56.7
Egypt	5.57	5.80	9.96	8.56	55,906.3	+1.0	+ 1.0	+ 4.0
Israel	4.54	4.37	8.11	5.42	879.8	+1.1	+ 6.3	+ 7.8
Saudi Arabia	3.75	3.75	6.70	4.97	13,817.9	+4.2	- 17.3	- 17.3
South Africa	6.18	6.07	11.0	7.15	21,354.0	+1.2	+ 18.0	+ 21.1
Czech Republic	22.8	23.3	40.8	2.14	1,547.7	+0.9	+ 5.1	+ 13.5
Hungary	213	193	382	6.21	24,775.1	+1.4	+ 19.2	+ 19.5
Poland	3.12	3.27	5.58	4.13	44,688.7	+4.6	+ 25.5	+ 31.0
Russia	23.4	27.7	41.8	12.00	1,669.2‡	+3.4	+ 20.7	+ 48.3
Turkey	1.33	1.37	2.37	14.13	44,745.5	+2.3	+ 12.5	+ 14.6
EM (MSCI)*	1.00	1.00	1.79	na	844.9	+0.8	+ 19.6	+ 19.6
EMBI+†	1.00	1.00	1.79	na	373.0	-0.1	+ 1.2	+ 1.2

*Emerging Mkts. †JPMorgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.